

Tax: Income and Other Taxes

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 both provincial and federal tax at graduated rates based on their income levels. The top marginal rate of tax (combined provincial and federal) for an individual resident in Ontario for 2026 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 30% in Prince Edward Island and Newfoundland & Labrador, 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 \$500,000 of

business income it earns each year, but some provinces have higher thresholds (such as \$600,000 in Saskatchewan and Prince Edward Island, and \$700,000 in Nova Scotia). In Ontario, the combined federal and provincial corporate income tax rate for a CCPC on the first \$500,000 of business income is 12.2% for 2026. 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 \$100 million and total assets of at least \$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.

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) (this is comprised of the 5% federal goods and services tax and an 8% provincial sales tax). 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 \$1 million while the minimum amount is \$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 \$100,000 and the annual net tax (whether remittable or refundable) is less than \$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 2026 is \$4,230.45.

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 2026 is \$1,123.07. The maximum annual employer premium per employee for 2026 is \$1,572.30.

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 \$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 \$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 \$200,000 to up to 1.95% for payroll in excess of \$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 \$1 billion. A financial institution can also offset its capital tax payable by its federal income tax payable for that fiscal year.

STAMP DUTIES

Canada does not impose stamp duties.

ANTI-AVOIDANCE

Changes to the general anti-avoidance rule ("GAAR") were enacted in 2024.

Under the GAAR's previous legislative regime, the Canada Revenue Agency ("CRA") could apply the GAAR to deny a tax benefit resulting from an avoidance transaction that may reasonably be considered to have resulted in a misuse or abuse of the ITA, or in an abuse having regard to the provisions at issue read as a whole.

Measures have been introduced to strengthen the efficacy of the GAAR. Specifically, these measures include the introduction of a preamble, a lower threshold for the avoidance transaction purpose test, an economic substance rule, a penalty, voluntary reporting and an extended reassessment period.

A preamble has been added to the beginning of section 245 to codify the GAAR's purpose. However, it is intended to be informative and not meant to inform the GAAR's "analytic framework." The preamble clarifies that the GAAR serves as a limit on tax planning. While individuals can still benefit from the ITA's tax incentives, the freedom to tax plan "does not extend to misusing or abusing the tax rules," according to the Department of Finance. Additionally, the preamble codifies the balance the GAAR is intended to strike between the government's responsibility to protect the tax base and the fairness of the tax system, and the requirement for certainty for taxpayers planning their affairs.

The introduction of a lower threshold for the avoidance transaction purpose test is meant to ensure that the GAAR "prevent[s] abusive tax avoidance when a tax benefit is achieved in the context of a transaction with a primarily non-tax purpose." Under prior legislation, the GAAR applied to an avoidance transaction unless the transaction was undertaken for **primarily** genuine purposes other than obtaining a tax benefit. The amendments to the legislation change this threshold. Under the changes, an avoidance transaction will be considered an avoidance transaction if the transaction or series of transactions results in a tax benefit, unless it may reasonably be considered that obtaining a tax benefit was not **one of the main purposes** for the transaction.

An economic substance rule has been added to the GAAR, introducing an indicator for determining whether a transaction may be a misuse or abuse of a provision or the whole of the ITA. Specifically, if an avoidance transaction is significantly lacking in economic substance, this will be an important consideration that tends to indicate misuse or abuse. The legislation provides non-exhaustive factors that may establish a lack of economic substance, including a lack of opportunity for gain or profit and risk of loss for the taxpayer, the expected value of the tax benefit exceeding the expected non-tax economic return and the purpose for entering the transaction being to obtain the tax benefit.

Voluntary reporting, a new penalty and an extended reassessment period have also been introduced. Taxpayers will have the option to voluntarily report transactions they believe may come within the ambit of the GAAR, using either the GAAR's new voluntary disclosure rules or the new mandatory disclosure rules. If a taxpayer voluntarily reports, this will preclude the application of the new penalty and the extended reassessment period. The new

GAAR penalty will result in a 25% penalty on the amount of tax payable if a taxpayer's tax increases as a result of the GAAR. Further, under the extended reassessment period, transactions subject to the GAAR may be assessed up to three years beyond the normal reassessment period.

In addition to voluntary reporting precluding the application of the new penalty, the penalty may not apply if it is reasonable to conclude that the "transaction or series would not be subject to the GAAR at the time it was entered into." To benefit from this exemption, it must be reasonable to conclude that the transaction would not give rise to the application of the GAAR because the transaction undertaken was "identical or almost identical" to one published in administrative guidance or a court decision.

MANDATORY DISCLOSURE RULES

Undergoing certain transactions in Canada may result in information reporting requirements to the CRA. In recent years, Canada has expanded its existing rules for mandatory disclosure to better align with best practices from the Organisation for Economic Co-operation and Development ("OECD") Base Erosion and Profit Shifting ("BEPS") Project and Action Plan on mandatory disclosure. There are now three sets of mandatory disclosure rules to be cognizant of when doing business in Canada.

1. The Reportable Transaction Rules

In 2023, Canada expanded the existing regime for "reportable transactions" to lower the threshold for when reporting will be required, applicable to transactions entered into after June 22, 2023. Under the new rules, if a transaction qualifies as an "avoidance transaction" and meets one of three generic hallmarks, an information return must be filed to report the transaction. Previously, two generic hallmarks were required under a narrower definition of "avoidance transaction." An avoidance transaction exists where it can reasonably be considered that obtaining a tax benefit is one of the main purposes, either for the transaction itself or for a series of transactions of which the transaction is a part. The three generic hallmarks (of which only one is required to trigger disclosure) are:

- a contingent fee arrangement, where a promoter or advisor (or any person non-arm's length thereto) is entitled to a contingent fee that is either:
 - based on the amount of the tax benefit that results from the transaction or series;

- contingent upon obtaining the tax benefit that results from the transaction or series; or
 - attributable to the number of persons that participate in the transaction or a similar transaction, or that have been provided access to advice or an opinion given by the advisors or promoters in respect of the tax consequences from the transaction or series or a similar transaction or series;
 - where an advisor or promoter (or any non-arm's length person thereto) obtains confidential protection, that is, where there is an agreement to prohibit disclosure of the details of the structure that gives rise to tax benefits to any person or the tax authorities; and
 - where the taxpayer or transaction participant, or an advisor or promoter, obtains contractual protection, that is,
 - a form of insurance, protection, indemnity, compensation or guarantee that protects against the failure to achieve tax benefits or pays or reimburses fees, expenses, taxes, interest and penalties in the course of a dispute of the tax benefit; and
 - any form of undertaking provided by a promoter (or any non-arm's length person thereto) to assist a person in the course of a dispute in respect of a tax benefit from the transaction or series.
 - every advisor or promoter (or non-arm's length person thereto) in respect of a reportable transaction who is or was entitled to a contingent fee or a fee in respect of a contractual protection.
- The following information must be disclosed on the prescribed form for a reportable transaction (or series):
- identification of the person required to disclose and the person obtaining the tax benefit;
 - a description of the reportable transaction in sufficient detail for the Minister to be able to understand the tax structure;
 - the date the reportable transaction is required to be disclosed (90 days from the date the transaction was entered into or the time of becoming contractually obligated to enter into the transaction);
 - identification of the advisors and/or promoters in respect of the reportable transaction;
 - the amount and nature of the tax benefit, including whether it is recurring, and in which years the tax benefit is expected to be used;
 - the legislative provisions applied; and
 - calculation of any late-filing penalty.
- Information is not required to be disclosed if it is reasonable to believe the information is subject to solicitor-client privilege.

Notably, the hallmark for contractual protection will not be met solely by the presence of standard professional liability insurance or an agreement integral to an arm's length sale where it is reasonable to consider the insurance or protection is intended to ensure that the purchase price paid under the agreement takes into account any liabilities of the business immediately prior to the sale or transfer, and is obtained primarily for purposes other than to achieve any tax benefit from the transaction or series.

The following persons must file an information return in respect of a reportable transaction (or series):

- every person for whom a tax benefit results or is expected to result from the "tax treatment" of the reportable transaction, series or other such transactions that are part of the series;
- every person who has entered into the reportable transaction for the benefit of a person described in paragraph (a); and
- straddle loss transactions using a partnership;
- transactions to avoid Canada's 21-year deemed realization rule for a trust;
- the manipulation of bankrupt status to reduce a forgiven amount in respect of a commercial obligation;
- transactions undertaken to avoid a deemed acquisition of control; and

- back-to-back arrangements intended to circumvent the thin capitalization rules or part XIII tax.

The scope of the notifiable transaction regime is significantly broad, as a notifiable transaction includes a transaction that is “substantially similar” to one that is designated. The term “substantially similar” is defined to refer to “any transaction, or series of transactions, in respect of which a person is expected to obtain the same or similar types of ‘tax consequences’...and that is either factually similar or based on the same or similar tax strategy; and is to be interpreted broadly in favour of disclosure.”

The same persons as noted above in respect of a reportable transaction (or series) must file an information return in respect of a notifiable transaction (or series).

The prescribed form for reportable transactions is the same as for notifiable transactions. The following specific information must be included in respect of a notifiable transaction (or series):

- identification of the person required to disclose and the person obtaining the tax benefit;
- identification of which type of notifiable transaction is being disclosed;
- the date the notifiable transaction is required to be disclosed (90 days from the date the transaction was entered into or the time of becoming contractually obligated to enter into the transaction);
- the nature of the tax benefit, including whether it is recurring, and in which years the tax benefit is expected to be used;
- whether the transaction is the same as a transaction designated by the Minister or substantially similar;
- a brief description of the reason you are disclosing the notifiable transaction; and
- calculation of any late-filing penalty.

Information is not required to be disclosed if it is reasonable to believe the information is subject to solicitor-client privilege.

3. The Rules for Uncertain Tax Treatments

In 2023, Canada also introduced new rules that require certain corporations to disclose tax treatments in respect of which uncertainty is reflected in their financial statements for the year.

These rules only apply to corporations that meet the following criteria:

- the corporation has audited financial statements prepared in accordance with IFRS or other country-specific generally accepted accounting principles (“**GAAP**”) relevant for corporations that are listed on a stock exchange outside Canada;
- the carrying value of the corporation’s assets is greater than or equal to \$50 million at the end of the year; and
- the corporation is required to file a return of income for the year.

Consequences for Non-Compliance

Where the foregoing mandatory disclosure rules are not complied with, the limitation period for reassessment will not commence in respect of the reportable transaction, notifiable transaction or the uncertain tax treatment until the particular transaction or tax treatment has been disclosed. As a further consequence of non-compliance, the third condition of Canada’s general anti-avoidance rule – that the transaction or series results in a misuse or abuse of the provisions that give rise to the tax benefit – will not apply until the return for a particular reportable or notifiable transaction (or series) has been disclosed.

Penalties for late-filing or a failure to file will also apply. Taxpayers who fail to file an information return in respect of a reportable or notifiable transaction as required may be subject to penalties up to the greater of \$25,000 (or \$100,000 for corporations with assets or total carrying value of \$50 million or more) or 25% of the tax benefit. Promoters or advisors who fail to file the same return may be subject to penalties equal to the total of 100% of the fees charged to a person for whom a tax benefit results, \$10,000 and \$1,000 per day the failure continues, up to \$100,000.

Failure to report an uncertain tax treatment may result in penalties up to a maximum of \$100,000.

A person will not be subject to penalties for failure to disclose a reportable transaction, notifiable transaction or uncertain tax treatment where the person required to file the return exercised the same degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. With respect to notifiable transactions, the CRA’s guidance is that this due diligence defence will generally be available where a person asks their

advisors about potential reporting obligations and is informed that no such reporting obligations exist. For reportable transactions and uncertain tax treatments, an objective standard of a “reasonably prudent person” will apply, based on the facts and circumstances of each case.

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