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TOUCHE ROSS INTERNATIONAL

business study canada

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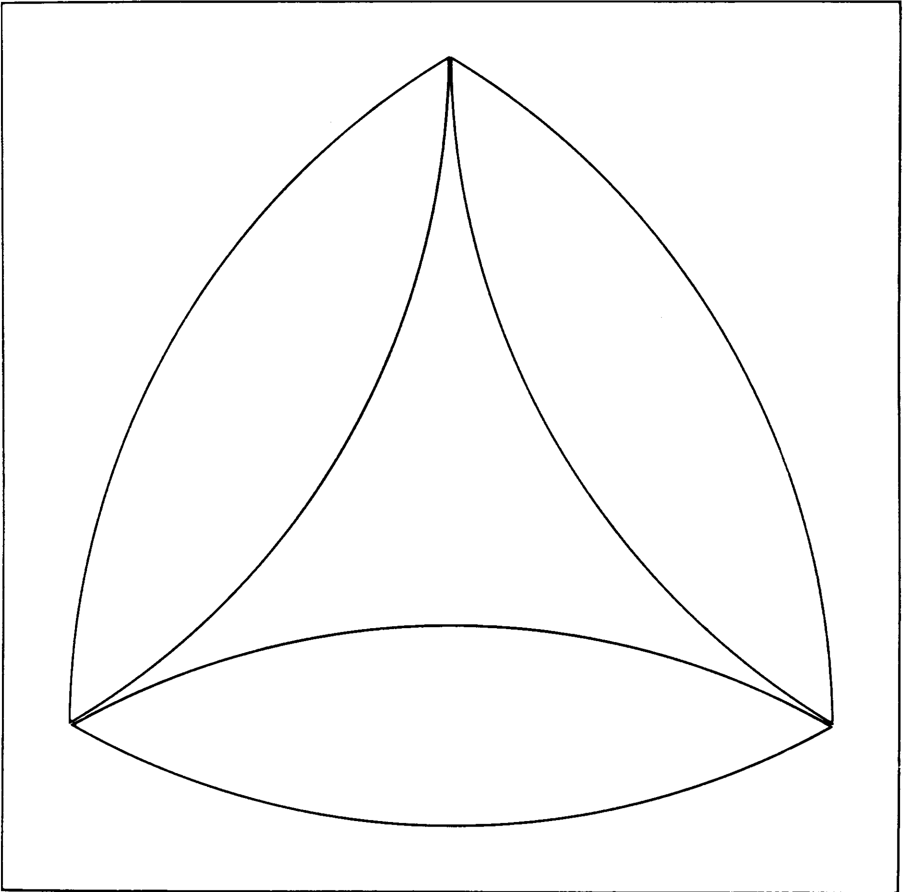

Preface

This is one of a series of Business Studies designed for the use of the Touche Ross professional staff in all countries and for interested clients. Users of this Study should ascertain that the information contained here has not been superseded by later developments. Specific business questions or problems may have legal and tax *ramifications* that are beyond the scope of this Business Study and the assistance of professional advisors is recommended. Suggestions for revisions should be sent to the Touche Ross International Executive Office.

January, 1975

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TOUCHE ROSS INTERNATIONAL

business study

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CHAPTER II INVESTMENT FACTORS
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CHAPTER IV BUSINESS PRACTICES AND INFORMATION
CHAPTER V FORMS OF BUSINESS ENTITIES
CHAPTER VI ACCOUNTING AND AUDITING
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NOTE: Throughout this Business Study, all amounts are in Canadian dollars and are written with the dollar sign ($).

Introduction

Canada started as a nation of immigrants and still welcomes newcomers. More than three million immigrants have settled in Canada since 1945. Canada also began as an exporter of primary commodities. Over the years, however, its economy has become more balanced between exploitation of natural resources and industrial production.

Among the chief factors in the Canadian success story have been substantial foreign investment, access to technology, access to markets, and widespread sharing of the benefits flowing from abundant natural resources. Canada has not escaped the ravages of inflation and recession but, to this point, Canada's economy has not been as ravaged as most developed countries.

Canada is energy-rich. The recent rise in oil prices, however, has not brought substantial benefits because oil exports from Western Canada are just about counterbalanced by the oil imports of Eastern Canada.

The Canadian population, labor force, market, and industrial production have all been growing at levels above those of most other countries. Aside from ordinary business problems, the general situations in Canada that potential foreign investors must evaluate are the persistent French-English cultural disagreement, the growing Canadian determination, as evidenced in the Foreign Investment Review Act, to restrict foreign investment that does not benefit Canada, and the particular policies of each province.

Alexander Berger
Director of International Publications
January, 1975

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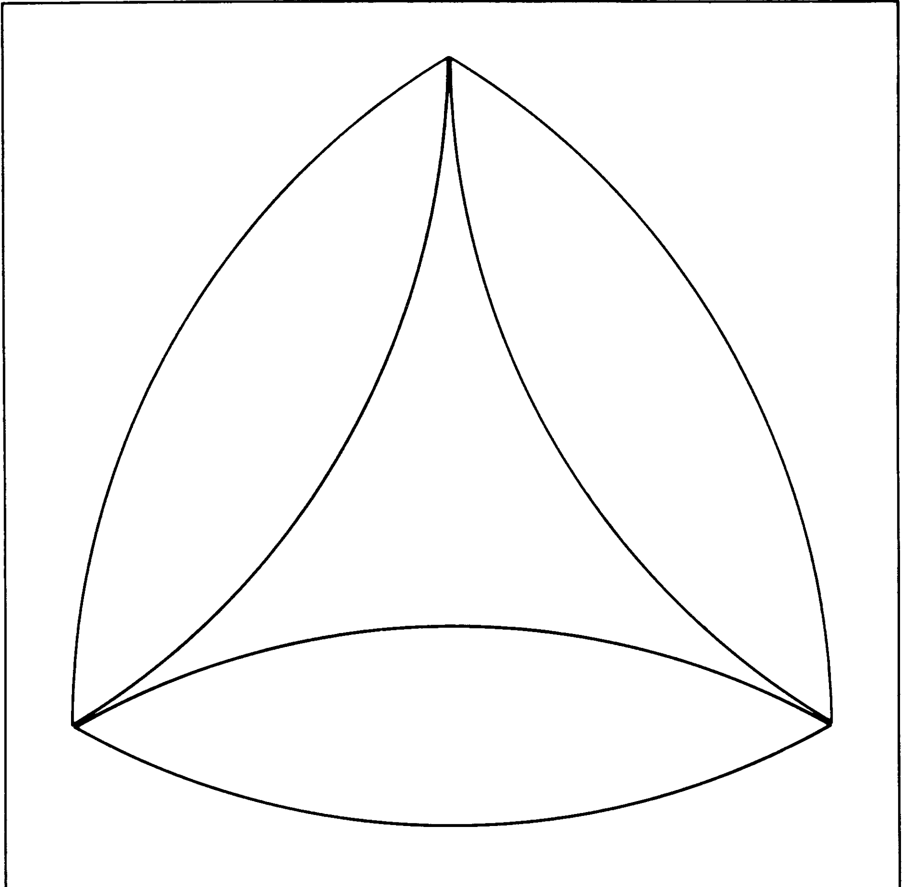
CHAPTER I

Canada in Brief

Physical Geography
The Canadian People
History
Government
The Canadian Economy



Canada in Brief

Canada occupies the entire north of the North American continent except for Alaska, the island of Greenland (part of Denmark), and the small French-held islands of Saint Pierre and Miquelon. The word *Canada* is thought to have originated from the Iroquoian Indian's word to describe a group of huts, *Kanata*, and was their name for a region near the city of Quebec.

Canada consists of the ten provinces and two territories described later. As is evident from a map of Canada, the provinces and territories were largely drawn on the basis of parallels and meridians, except that a few natural divides were taken into account. For example, the Rocky Mountain Divide forms part of the border between Alberta and British Columbia and between the Yukon and Northwest Territories.

PHYSICAL GEOGRAPHY

Area. Canada's 3.85 million square miles make it the world's second largest country (compared with Russia's 8.6 million square miles). About 7.6% of Canada's area consists of fresh water, of which Canada has over 15% of the world's volume. Canada extends 3,223 miles from east to west and 2,875 miles from north to south.

Although Canada is larger than the United States, its nearest neighbor, its population is only about 10% that of the United States. For purposes of comparison, Canada is 40 times larger than Britain and 18 times larger than France. Canada has an immense coastline as it has oceans on three sides (the Atlantic, the Arctic, and the Pacific).

Terrain. Canada's most unusual geographic feature is known as the *Canadian Shield*, which covers almost half of Canada. The term *Shield* derives from its hard crystalline rocks which have great rigidity and strength, and from its great geologic age. The Shield is shaped like a V, with the sides curving up around Hudson Bay and the bottom point extending into the Adirondack Mountains in New York State and areas in Michigan, Wisconsin, and Minnesota.

The Shield is extremely complex geologically. Its formation dates back to great lava flows and the subsequent ice age. The Shield's general rockiness, many swampy areas, hills, and lack of tillable soil made it a barrier to the early settlers, and the areas to the east and west of the Shield developed separately. However, the Shield's forests, water power, and abundant minerals are transforming it into an important asset.

Canada in Brief

Borders with United States. The Canadian-Alaska border is 1,456 miles long, and the southern Canada-U.S. border extends for 3,987 miles. Although Canada is popularly conceived of as being north of the U.S., Windsor in the province of Ontario, which is actually south of Detroit, Michigan, is on a parallel with part of California. Furthermore, portions of 24 states lie north of the most southern portion of Canada—Middle Island in Lake Erie.

Border conflict between New York and Quebec was settled by the choice of the 45th parallel as the boundary. The 49th parallel forms the boundary line between the western areas of Canada and the United States.

Climate. Especially in northern areas, winters are long and cold, and summers are short with temperatures varying from cool to very hot. In Arctic areas, and even in northern parts of the prairie provinces, winter temperatures are frequently −30° to −40° F for extended periods.

From a tourist's point of view, every season has its attractions. Many visitors come to Quebec and the western mountain region for skiing. Spring and autumn are usually mild and a very pleasant time to visit. But most visitors come during the summer to enjoy the lakes and rivers or the mountains. Summer temperatures are usually in the 70° to 80°F range but may vary from cool to quite hot—up to 90° to 95°F.

Southern winters are often cold and the snowfall heavy in some areas. However, only an exceptional storm closes airports or inhibits other forms of transportation. An indication of temperatures can be obtained from the following average daily lows and highs for selected months.

	Vancouver	Montreal	Toronto
January	33 - 42°F	8 - 23°F	18 - 31°F
April	42 - 58°F	34 - 50°F	36 - 52°F
July	55 - 74°F	62 - 79°F	61 - 81°F
October	45 - 58°F	41 - 56°F	42 - 58°F

Canadian Provinces. Canada is divided into ten provinces and, in the far north, two territories. The authority of the provinces is considerable, notwithstanding Canada's federal structure. Each province has many spheres in which it is sovereign, and each administers its own natural resources. The resources of the two territories, for practical purposes, are administered by the federal government in Ottawa.

Province	1974 Estimated Population In Thousands	Capital	Square Miles
Ontario	8,031	Toronto	412,582
Quebec	6,112	Quebec	594,860
British Columbia	2,369	Victoria	366,255
Alberta	1,702	Edmonton	255,285
Manitoba	1,005	Winnipeg	246,512
Saskatchewan	906	Regina	251,700
Nova Scotia	810	Halifax	21,068
New Brunswick	658	Fredericton	27,985
Newfoundland	540	St. John's	155,364
Prince Edward Island	116	Charlottetown	2,184
Territory			
Yukon	20	Whitehorse	207,076
Northwest	38	—	1,304,903
	22,307		3,845,774

Principal Cities. The June, 1973 population of Canada's metropolitan centers was 12.164 million or 55% of all Canadians. The population of the eleven largest metropolitan areas in mid-1973 was:

City	Population	Province
Montreal	2,775	Quebec
Toronto	2,692	Ontario
Vancouver	1,116	British Columbia
Ottawa—Hull	619	Ontario
Winnipeg	560	Manitoba
Edmonton	518	Alberta
Hamilton	513	Ontario
Quebec	493	Quebec
Calgary	431	Alberta
St. Catharines/ Niagara Falls	308	Ontario
London	293	Ontario

Principal Regions. The understanding of Canadian regionalism is relevant in both geographic and economic terms. It also has political significance because it reflects the fact that Canada is, in many respects, a fairly loose federation with strong regional interests and with some antipathies between regions. Consequently, the need for astute politicians and policies is great.

The Atlantic Provinces. The Atlantic, or Maritime, Provinces consist of Newfoundland, Nova Scotia, New Brunswick, and Prince Edward

Island. Although Newfoundland is partly an island of approximately 43,000 square miles, it includes some 113,000 square miles of Labrador, which is on the mainland. Labrador is where the world's largest underground power station is being built to harness Churchill Falls. When completed, this hydroelectric project will generate 5.25 million kilowatts.

The region is not industrialized. Its economy is principally fishing, lumbering, farming, and some mining. However, because the region has been recognized as disadvantaged, federal and provincial incentives have encouraged the development of industry. Average wages are low, but the standard of living is improving slowly. Nova Scotia has the only steel mill in the Atlantic Provinces.

The Central Provinces. Quebec and Ontario are referred to as the Central Provinces. Quebec is the largest province in area and Ontario is the largest in population. Ontario is second in size and Quebec is second in population. These provinces also contain most of Canada's industry, commerce, and financial institutions. Many new businesses locate in Ontario or Quebec because they are business and population centers. Seven of the eleven largest cities are in these two provinces. Many Canadian industries are dominated by a few large enterprises and these are often highly concentrated geographically, with Montreal (Quebec) and Toronto (Ontario) being focal points of this concentration.

The standard of living and life style in the Central Provinces are fairly close to those of the industrialized areas in the United States.

The Prairie Provinces (Manitoba, Saskatchewan, and Alberta). The Prairie Provinces are not protected by mountain barriers. Cold air from the Arctic moving south and warm air from the central U.S.A. moving north are unimpeded. Consequently, the variation between summer and winter temperatures, as well as the day-to-day variation, can be greater than in any other part of Canada.

The Prairie Provinces provide the wheat and other grains that are Canada's main agricultural export. The Prairie Provinces also produce beef cattle for export as well as home consumption. The agricultural landscape is increasingly being marked with industrial establishments as large quantities of oil, natural gas, coal, and potash have been found and developed. Of even greater future importance are the Athabasca tar sands whose vast oil potential is just beginning to be tapped.

The Pacific Coast Province of British Columbia. British Columbia is Canada's most western province. It includes a mountainous area as

well as the Pacific Coast. The coastal climate is the mildest in Canada and includes heavy rainfall. The main industries are lumbering, fishing, mining, and related activities. The abundant rainfall provides water power, which is used for such purposes as aluminum production.

Much of the province's business is concentrated in the coastal city of Vancouver, which is Canada's third largest city and major port on the Pacific Ocean. The capital city of Victoria, situated on Vancouver Island, is largely occupied with government business and is a center for retired persons. The province is one of Canada's wealthiest.

The Arctic Northwest (Yukon and Northwest Territories). These vast territories consist of arctic tundra, fresh water lakes and oceans; are sparsely inhabited by Eskimos and Indians; and are largely underdeveloped. Whatever economy exists is based on the extraction of minerals. Oil and gas exploration is being actively carried on, and the prospects for finding large reserves appear bright. The Northwest Territories occupy more than one-third of Canada.

Natural Resources. The Canadian Shield, mentioned under *Terrain*, contains a vast treasure of minerals, including gold, silver, platinum, copper, nickel, lead, zinc, iron, radium, uranium, asbestos, and many others.

Petroleum and natural gas are also abundant. For many years, Canada has been the largest foreign supplier of oil to the United States. Formerly exporting about one million barrels a day to the U.S., Canada is currently eliminating the exports gradually so that by 1983, no oil will be exported to the United States. The oil has come from Western Canada, while at the same time Eastern Canada has imported oil from Venezuela and the Middle East. Although western oil and gas reach the Toronto area, the oil pipeline is inadequate to carry western oil to Montreal. This is responsible for the anomaly of exporting oil to the U.S. at the same time that oil is imported. This situation will be changed by a west-east pipeline that is being built to supply Eastern Canada from the western oil fields.

The enormous deposits of tar sands in Northern Alberta provide only about 2% of Canada's oil production, but their high potential is being studied and large-scale production is expected when justified by the cost-price ratio. Alberta is the source of most of Canada's oil and gas production and, also, 42% of its coal.

Because of the climate, mountains, and the Shield, only about five percent of the land is suitable for farming. The best farm areas are the

rich black soils of the prairies and the gray-brown soils of the St. Lawrence – Great Lakes area.

THE CANADIAN PEOPLE

Most of Canada's over 22 million people live in the corridor 100 to 200 miles wide that extends along the southern border with the United States. Cities in this area and throughout Canada are often a significant distance from one another. Thus, the automobile and other forms of transportation are relatively more important in Canada than in other countries. This is evidenced by Canada's 9.5 million motor vehicles — almost one vehicle for each two Canadians.

Language. Canada has two official languages — English and French. The French language is used primarily in Quebec, where the majority are of French origin. Most Canadians (62.4%) speak only English while 19.1% speak only French and 12.2% speak both languages. The language issue, which is part of a broader cultural conflict, has proved contentious, and a political polarization has developed around this issue that remains one of Canada's serious problems. In 1969, the Official Languages Act was adopted by the federal government. One of its stipulations is that English and French "possess and enjoy equality of status and equal rights and privileges as to their use in all the institutions of the Parliament and Government of Canada."

In 1974, Quebec passed legislation that will require a fairly rapid transition to French as the primary language of business in that province (for more details, see the beginning of Chapter 2). In addition, primary education in Quebec is now in French, except for children whose first language is English.

Life Expectancy. The 1966 census indicated that life expectancy at birth for males was 68.75 years. This had increased to 69.34 years by the 1971 census. The corresponding increase for females was 75.18 to 76.36 years.

Divorce Statistics. Before grounds for divorce were broadened in 1968, the ten-year average was 8,500 divorces per year. By 1973, the number of divorces had increased to over 36,000 per year. The highest divorce rates are in Alberta, British Columbia, and Ontario (in that order).

Literacy Rate. For all practical purposes, the literacy rate is 100%.

Ethnic Origin. The 1961 census indicated that 43.8% of Canadians were originally from the British Isles and 30.4% from France. The rest are largely from other European countries. Before the Europeans arrived, "Canada" was inhabited by Eskimos and Indians, who constituted 1.2% of the 1961 population.

Religion. The three largest churches (in order of size, Roman Catholic, United Church, and Anglican) comprise nearly 80% of the population. Many small denominations exist, including the Quakers, Unitarians, Evangelicals (of which the largest is the Pentecostals), Eastern Orthodox, Jews, Hutterites, and many others. Canada is as free from religious intolerance as any other country.

Standard of Living. As conventionally measured, Canadians enjoy one of the world's highest living standards. For example, 1971 figures of telephones and television sets per 1,000 inhabitants ranked the leading countries as follows:

	Telephones	Television Sets
U.S.	604	449
Sweden	557	323
Switzerland	509	229
Canada	468	349

In public expenditure on education as a percentage of gross national product, Canada's 9.10% was far more than the 5.4% of the U.S. and was the highest percentage of any country in 1970—the year in which this statistic was compiled.

Education. Education in Canada is under provincial jurisdiction and is compulsory from age 6 to 14 or 16, depending on the province. Except for private schools, education and textbooks are free through secondary schools. School terms begin in September, and schools close in July and August for the summer vacation.

In Quebec and Newfoundland, most elementary and secondary schools are run along denominational lines.

Education is financed almost entirely by provincial grants and local property taxes. However, the federal government provides much financial assistance to help in vocational and technical training in courses arranged by a federal Manpower Office and in apprenticeship training programs.

All universities charge tuition, but federal and provincial grants make tuition fees bear only a minor portion of the cost of a university education. Furthermore, both federal and provincial governments

provide grants and scholarships to worthy students as well as low-cost loans to needy students.

HISTORY

Canada's discovery and settlement are similar in many ways to the experience of the United States, except that the process started later and was slower in Canada. In Canada, as in the U.S., colonies were started in a large land mass that was sparsely populated, and these colonies sought to expand. In both cases, European settlement spelled conflict and disaster for the natives, and both countries eventually developed into modern industrial states, aided by fertile land and abundant natural resources.

Canada's history has been greatly influenced by its rivers. The fur trade, the first industry, grew because of the easy access to the interior provided by the St. Lawrence River, the Great Lakes, Hudson Bay, and the many smaller bodies of water. Early exploration and settlement were also influenced by these water routes. Farmers were attracted to the flat, fertile plains of southern Ontario and Quebec because of the plentiful water. Lumber first became important because water transportation was available and, later, water-driven turbines helped to build an industrial base. Water is still important in providing energy, transporting bulk raw materials, and processing these materials.

The English and French colonists chose to remain loyal to Great Britain when the American Revolution broke out in 1775, but both countries today enjoy an equal measure of freedom.

GOVERNMENT

Canada is an independent democratic country consisting of ten partially self-governing provinces and two federally-governed northern territories. Canada is entirely independent although maintaining traditional ties with the United Kingdom as a member of the British Commonwealth of Nations. Modeled on the British parliamentary system, Canada's national government consists of three branches — executive, legislative, and judicial.

The Constitution. The written constitution of Canada is embodied primarily in the British North American Act of 1867, which, with its later amendments, is collectively known as the British North American Acts, 1867 to 1964. The first Act in 1867 established a federal form of government and the institutions through which legislative, executive, and judicial powers are exercised. Canada's unwritten constitution is

also important and consists of English common law, judicial interpretations, historical declarations, and long-standing customs.

Unlike the situation in other commonwealth countries, the first British North American Act did not provide Canada with an amending procedure and is the reason successive amendments to the British North American Act were passed by the British Parliament at the request of Canada.

The 1931 Statute of Westminster altered some of the provisions of the British North American Act. This Statute gave the Canadian Parliament authority to make laws having extraterritorial effect and to repeal any British law that is part of the law of Canada except for the British North American Act itself.

The federal government is responsible for such matters as defense, foreign affairs, banking, transportation, criminal law, and all other areas not specifically defined in the British North American Acts.

The provincial governments are responsible for such matters as education, natural resources, property law and, to a great extent, labor law.

The Executive Branch. Formal executive power is vested in the Queen. Her authority is delegated to her representative in Canada, the Governor-General, whose executive powers are exercised only on the advice of the Cabinet, and whose legislative powers are exercised only on the advice of the two Houses of Parliament. The Governor-General appoints the Prime Minister, usually the leader of the majority party in the House of Commons. The Prime Minister selects 25 or more individuals from his party to serve as Ministers in his Cabinet. The Cabinet, including the Prime Minister, determines important policies, attempts to secure enabling legislation, and gives effect to policy changes in its respective departments.

The Legislative Branch. Legislative power is vested in the Parliament of Canada, which consists of the Queen, an appointed "upper" house called the Senate whose members are appointed for life or until retirement at age 75, and a "lower" house called the House of Commons whose 264 members are elected for a maximum term of five years. The Senate cannot initiate financial legislation and cannot unseat the government. The Prime Minister and most members of the Cabinet respond to questions daily when the House is in session. If the House votes lack of confidence or the government loses on a critical issue, it must either resign so that a new government can take its place or request dissolution so that a new election can be held. Otherwise, a

new election must be held every five years. However, except when the government has lost a vote of confidence in the House, the Prime Minister has the traditional right to select the time for calling an election. He may choose any opportune time to strengthen his support in the House or to obtain electoral approval on a contentious issue. As waiting until the end of the maximum five-year term does not afford much leeway, the Prime Minister will usually call an election at least a year or more prior to that time.

All Canadian citizens 18 or over have the right to vote, except for prisoners and those confined for mental illness. British subjects who were at least 20 on June 25, 1967 and have resided continuously in Canada since then also have the right to vote. People who cannot go to the voting place for various reasons may vote by proxy or in an advance poll one week before the regular election.

The Prime Minister and his Cabinet must be members of Parliament, usually of the House of Commons. On occasion, nonmembers of Parliament have been appointed to the Cabinet, and they have stood for election at the first opportunity. Members of Parliament (M.Ps.) need not live in the election district in which they run for office.

All legislation must be read three times in both houses before becoming law. The first reading is purely formal.

Political Parties. Two parties — the Progressive Conservatives, usually called the Conservatives, and the Liberals — are the major political organizations. All governments since 1920 have been formed by one of these parties. Other parties are easily formed and regularly elect some members to the House of Commons. The most prominent are the New Democratic and Social Credit (Ralliement Créditist) Parties.

The Judicial Branch. Under Section 92 of the British North American Act of 1867, each province determines its civil law, the judicial procedures employed in civil cases, and the establishment of its courts for both civil and criminal cases. Civil law in Quebec is based on the French Civil Code (Napoleonic Code) but in all other provinces is based on English common law. Criminal law is under federal jurisdiction. Consequently, most commercial law originates in each province, while federal criminal law applies throughout Canada.

Most Canadian courts are provincial and are organized in a similar pattern that culminates in a provincial supreme court and court of appeals. The federal judiciary consists of the Supreme Court of Canada, the Federal Court of Canada, and certain miscellaneous courts

such as Tax Appeal Board, Immigration Appeal Board, etc. The Federal Court consists of an appeals division and a trial division that has original jurisdiction in all cases against the Canadian government.

The British North American Act provides that the salaries, allowances, and pensions of federal and provincial judges above the county level be fixed and provided by Parliament. Provincial judges are also federally appointed.

Jury trials are required in some cases, and may be requested in others, but most cases are heard only by a judge or magistrate. Where jury trials are held, the standard number of jurors is twelve, except in the territories where six jurors are standard.

Provincial Government. Provincial government is basically similar to that of the federal government. Each province is headed by a Premier (Prime Minister in Quebec and British Columbia) who is usually the leader of the majority party. The legislature, however, is unicameral and consists of a Lieutenant-Governor appointed by the federal Cabinet and a legislative assembly elected for a statutory term of not more than five years and subject to being dissolved within that period by the Lieutenant-Governor on the advice of the Premier.

The Constitution assigns specific areas of legislation to the provincial governments, including the regulation of municipal institutions. In recent years, the strength of provincial governments relative to the federal government has been increasing. Consequently, it is becoming increasingly important that foreign investors or potential investors obtain reliable and continuing information about political and economic policies at the provincial level.

Municipal Government. Municipal governments vary widely in form, as municipalities are under the jurisdiction of the provinces. Generally, each municipality is governed by an elected council whose head may be called the mayor, reeve, overseer, or warden. The municipality is responsible for such matters as police and fire protection, roads, public transportation, sewers and water supply, and collection of local property taxes for educational purposes.

THE CANADIAN ECONOMY

Canada is an advanced industrialized country and, consequently, its economy is complex. Agriculture now accounts for only 15% of economic activity.

Canada in Brief

Probably the single most important factor in the Canadian economy is the influence of the U.S. economy or, at least, U.S. economic policy.

Economic statistics for all of Canada can be very misleading since variations from one province to another — both total and per capita — are significant.

Government and the Economy. The Canadian economy contains mixed elements. In selected areas, the government owns and controls industry. Sixty percent of the railway system, for example, is publicly owned and operated as the Canadian National Railway system. The Canadian Pacific Railway Company, which operates most of the remaining forty percent, is owned by private shareholders, although regulated by the government. The two transcontinental systems use about 62,000 miles of track. They carry about 43% of the ton-miles of freight but less than 3% of passenger traffic. Automobiles account for about 83% of all passenger miles.

Of the two major airlines, Air Canada is government-owned and Canadian Pacific Airlines is operated by a subsidiary of the Canadian Pacific Railway Company.

Electric utilities are state-owned in most provinces. Telephone companies are privately owned in all but the three Prairie Provinces.

Consumer Price Index. No industrialized country has escaped inflation, but Canada's rate of inflation has been among the lowest. On a scale in which 1961 prices = 100, the price index has risen to:

1972 - 139.8
1973 - 150.4
1974 (March) - 160.8

Gross National Product. Canada's gross national product has grown as indicated below in Canadian $ millions. (The percentages indicate the increase over that of the previous year.)

Year	1961 Prices	%	Current Prices	%
1965	50,685	6.7	55,364	10.1
1970	64,046	2.6	85,610	7.3
1972	71,722	5.8	103,407	10.7
1973	76,815	7.1	118,678	14.8

On a per capita basis in current prices, Canadian and U.S.A. per capita income compares as follows:

	Canada (Can. $)	U.S.A (U.S. $)
1965	2,818	3,515
1970	4,020	4,720
1972	4,737	5,519

Government Revenue and Expenditures. The following statistics are on a national income and expenditure accounts basis (millions of U.S. dollars).

	Federal Government		Provincial and Local Government	
	Revenue	*Expenditures*	*Revenue*	*Expenditures*
1969	14,490	13,469	16,187	16,406
1972	19,334	20,035	22,751	24,058
1973	22,290	22,304	25,224	26,844

Foreign Trade. Foreign trade is important to Canada. Imports and exports as a percentage of Canada's gross domestic product compare with other countries as follows:

	Netherlands	Canada	Japan	U.S.A.
Imports as % of GDP	47.4	21.1	9.2	5.9
Exports as % of GDP	47.5	21.7	12.0	5.3

Leading Trade Partners. Canada's five leading trading partners are listed below (1971 statistics in millions of dollars):

	Exports To	Imports From
United States	$11,665	$10,944
United Kingdom	1,346	837
Japan	789	802
Germany	314	429
Netherlands	232	—
Venezuela	—	387

The U.S. is Canada's chief trading partner and vice versa by an extremely wide margin. The precise amount of their bilateral trade has been in dispute because Canada and the U.S.A. have used different concepts in compiling trade statistics. A joint committee charged with reconciling the differences has compiled the following reconciled figures (in millions of U.S. dollars):

Year	Exports to U.S.	Imports From U.S.
1971	12,017	10,567
1972	14,185	12,637

Canada in Brief

Composition of Foreign Trade. Nearly two-thirds of Canada's imports are either end-products or fully manufactured goods. Canada's exports are trending away from primary raw materials, with fabricated and end-products becoming predominant. Total exports and imports of goods and services in recent years follow:

	1965	1970	1972	1973
Exports	11,182	21,171	24,497	24,644
Imports	12,341	20,242	25,305	23,317
Net Balance	−1,159	+ 929	− 808	+1,327

For 1972, Canada's main exports, as a percentage of all commodity exports, were:

	%
Motor vehicles and parts	23.6
Other manufactures	16.5
Nonferrous metals and alloys	6.5
Lumber	5.9
Newsprint	5.8

And the main imports were:

Motor vehicles and parts	27.4
Producers' equipment	21.3
Industrial materials	20.8
Consumer goods	18.4

The composition of 1973 trade follows:

	Exports	Imports
End-products, inedible	8,259,686	14,797,912
Fabricated materials, inedible	8,187,377	4,280,107
Crude materials, inedible	5,007,321	2,010,765
Food, feed, beverages, tobacco	2,999,148	1,844,173
Live animals	144,688	137,105
Special transactions	45,355	246,744
	24,643,575	23,316,806

Foreign Investment in Canada. Over the years, the Canadian economy has been among the most open to foreign investment, and nonresident ownership and control are greater than in any other industrialized country. The U.S.A. is the source of most foreign

investment, accounting for over four-fifths of all foreign investment. At the end of 1972, direct U.S. investment amounted to $25.8 billion, 1.7 billion more than a year earlier. A striking feature of the 1972 increase was that most of it consisted of reinvested earnings ($ 1,367 million) as against net capital inflow ($380 million). U.S.A. direct investment in Canada was in the following major areas in ($ billions):

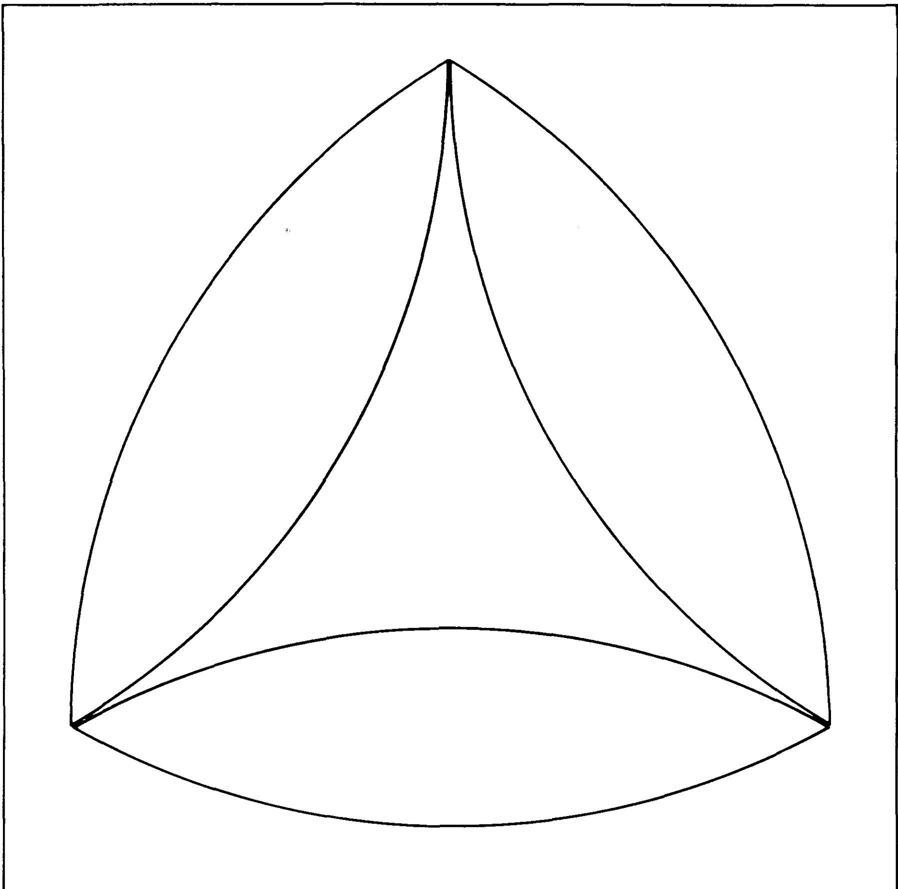
Mining and smelting	$ 3.5
Petroleum	5.3
Manufacturing	11.5
Other	5.4
	$ 25.7

Electric Power. Canada is second to the U.S.A. in per capita production of electricity. About 73% of Canada's electricity is generated from water power, which accounts for one of the world's lowest costs for electricity. In 1972, the average cost per kilowatt hour was 1.55 cents compared to 2.2 cents in the United States.

CHAPTER II

Investment Factors

Climate for Foreign Investment
Restrictions on Foreign Investment
Incentives for Foreign Investment
The Automotive Trade Pact
Special Investment Considerations
Patent, Industrial Designs, Timber Marks,
Copyrights, and Trademarks
Foreign Trade Regulations
Financial System and Credit Institutions



Investment Factors

CLIMATE FOR FOREIGN INVESTMENT

General Comments. In recent years, Canada has tended to be more nationalistic in its attitude towards foreign investment. However, despite the implementation of some controls at both federal and provincial levels, the climate for the foreign investor remains attractive.

With a history of stable government, a strong position in world trade, a significant share of the untapped natural resources of the world, and a geographic location that provides easy access to the large United States market to the south and to other world markets, the future of the Canadian economy appears bright.

Because of continuing changes in the outlook of both federal and provincial governments, it is important that a potential investor appreciate the implications not only of current legislation but also the relevant philosophies of these levels of government. In addition, of course, local or regional regulations imposed by municipal governments must be taken into account.

The matter of language also should be considered because, while English has been generally accepted as the language of business across the country, recent legislation stipulates that French is to be the official language in the province of Quebec and that most business communications within Quebec will have to at least use the French language. This means, for example, that Quebec entities selling goods or services to the Quebec Government will be required to use French since the language used for public administration is to be French; (moreover, communications with French-speaking clients will be in French).

Employers will be required to use the French language in notices, communications, and directions to their employees. However, if some employees speak only English, the notices, communications, and directions may be in both French and English.

Business firms that adopt Francisation programs will receive certificates to that effect. This will be mandatory for firms that either receive benefits from the government (premiums, concessions, or subsidies) or deal with the government (contracts, leases, or public works). Although the regulations to implement Francisation are not yet issued, it is obvious that the use of French will become imperative within a few years.

So far, the adoption of French by English business entities in Quebec has been relatively easy, with the Quebec Government allowing all necessary time to firms showing a willingness to make the transition.

Investment Factors

Because of Canada's proximity to the United States and its long history of trade with the United Kingdom, business operations follow similar patterns in these countries. Traditionally, foreign investment in Canada has come from the United States and to a lesser extent from the United Kingdom and other European countries. There are indications that this pattern is changing and, more recently, Japanese investment has been growing.

The federal government, the provincial governments, and many large financial institutions provide much relevant and accurate statistical data on Canada's regional and national economies. For example, the *Canadian Statistical Review,* published monthly by Information Canada under the authority of the Minister of Industry, Trade and Commerce, provides detailed data on both national and provincial trends.

In addition to statistical publications, the federal government maintains a world-wide network of trade offices in which qualified specialists provide guidance to potential foreign investors. Some of the provincial governments also maintain similar offices in selected countries for the purpose of providing information about their provinces.

Some restrictions exist on the industries in which foreigners may participate. The following businesses limit total nonresident ownership, and ownership by any one person or group, resident or nonresident, as follows:

Industry	Maximum Nonresident Ownership	Maximum Ownership by One Person or Group
Banking, Insurance	25%	10%
Broadcasting	20%	
Natural resources	50%	
Telsat Canada	20%	
Canada Development Corp.	3%	3%

In certain other industries (data processing, data files containing confidential information, and book publishing), moral suasion is utilized to restrict foreign ownership. The transportation industry restricts foreign participation through control of the issuance of licenses by the Air Transport Board in the case of airlines and by the Canadian Transportation Commission in the case of shipping. Trucking

is provincially regulated and is controlled by issuing licenses only where their need is demonstrated.

The rest of this chapter deals with specific factors affecting foreign investment in Canada, including restrictions on and incentives for foreign investment — both of which exist.

RESTRICTIONS ON FOREIGN INVESTMENT

Canada has a history of not only welcoming foreign investment but also of offering many incentives to attract foreign investment. The incentives available will be discussed later. Recently, Canada took an important step to insure that foreign takeovers of Canadian businesses are in the interest of Canada and to disqualify takeovers deemed not to be in the Canadian interest. The mechanism for accomplishing these ends is the following law:

The Foreign Investment Review Act. This Act, which became law on April 1, 1974, applies to the acquisition or establishment of businesses, with certain exceptions listed below. It does not apply to investment in securities solely for investment purposes. It was enacted by Parliament to enable the federal government to screen proposed foreign takeovers or proposed new businesses for their potential benefits to Canada.

The screening is carried out by the Foreign Investment Review Agency, the newly established screening board that reports to the Minister of Industry, Trade and Commerce. The screening is accomplished through detailed information that must be furnished by the foreign investor. The following criteria are used by the board in evaluating investment proposals:

1. The effect of the acquisition or establishment on the level and nature of economic activity in Canada.

2. The degree and significance of participation by Canadians in the business enterprise.

3. The effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation, and product variety in Canada.

4. The effect of the acquisition or establishment on competition.

5. The compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration policy objectives enunciated by the various provincial governments.

Investment Factors

Investment Proposals Subject to the Act. The Act applies to any acquisition of control of a Canadian business or the establishment of a new enterprise, with minor exceptions. The exceptions include:

1. Businesses whose gross assets do not exceed $250,000 and whose annual gross revenues do not exceed $3,000,000.

2. Government-owned "crown" corporations or provincially or municipally owned corporations.

Procedures for Foreign Investors. Regulations issued under the Act require that written notice of a proposed acquisition or establishment of a new business must be submitted to the Foreign Investment Review Agency, Ottawa K1A OM5. A detailed and comprehensive form is available from the Agency and must be used in making the written submission. The required information is very detailed and complex, and the services of competent legal and financial advisors are probably necessary in preparing the submission.

On receiving the submission, the Agency is required to send a certificate to the applicant by registered mail. The certificate is signed by the Commissioner of the Agency and indicates the date of receipt. The submission is then reviewed by the Minister; and within sixty days from the date of receipt, the Minister may recommend to the Governor in Council either that the investment be allowed or disallowed, or may notify the applicant by registered mail that additional information is required.

If no decision has been reached within sixty days of receiving the submission, and no notice has been sent by the Agency to the applicant, then the investment is deemed to have been approved.

As this new Act has been in effect only since April 1, 1974, it is difficult to predict the Agency's response to various types of investment proposals. While the guidelines are established, the matter of interpretation is very important. Extensive backup documentation in preparing submissions is obviously a key prerequisite.

Provincial Restrictions on Foreign Investment. The ten provinces have not legislated any restrictions on foreign investment, with the exception of foreign investments in real estate. Ontario has levied a special tax on foreign purchasers of land and some provinces are considering similar measures.

Ontario's Land Transfer Tax Act. Since April 10, 1974, nonresidents of Canada who purchase land in Ontario for any purpose

have been subject to a land transfer tax of 20% of the land cost. Canadian residents who purchase land in Ontario have been and still are subject to a land transfer tax of 3/10 of 1% on the first $35,000 and 6/10 of 1% on the excess.

Under the Act, a "nonresident" includes any person, association, partnership, syndicate, trust, or foreign incorporated or controlled corporation. In addition, where a nonresident acquires control of a corporation that owns land in Ontario, this is deemed a transfer of land and is subject to the 20% tax.

A review procedure is available for obtaining tax rebates under such circumstances as the resale of the land to Canadians in the form of housing or developed commercial premises within a specified period. Exemption may also be granted for foreign investment that creates jobs or settles in certain locations.

INCENTIVES FOR FOREIGN INVESTMENT

Both federal and provincial governments offer incentives to operating Canadian businesses, to new Canadian businesses, and to Canadian companies controlled by a foreign parent company. A large number and variety of incentives are offered, but this chapter will discuss only those whose broad applicability and practical usefulness have been demonstrated.

Federal Incentives. Tailor-made government plans have been developed for many industrial sectors. These plans result from a comprehensive study of an industry that takes into account such factors as the industry's technological development, its ability to compete internationally, its share of the domestic market, and the industry's general long-term viability. Such a study is the basis for an industry plan, which may include financial incentive programs, changes in tariff laws, or quota restrictions. Plans have been formulated for the automotive, footwear, tourism, textile, and clothing sectors. Other plans are being developed for the aerospace, shipbuilding, pulp and paper, sulphur utilization, and petrochemical industries. These plans, therefore, may contain incentives for particular industries.

Other incentives offered by the federal government include medium-term grant assistance for long-term research, soft loans for development of foreign markets (usually non-interest bearing and sometimes repayable only if the project succeeds), and special grants for specific industries.

Investment Factors

Incentives for "Designated Areas." The most significant federal incentives are the financial incentives provided for the establishment or expansion of businesses in "designated areas." These are regions whose economic development has lagged behind, and the federal government hopes to foster their economic development by offering generous incentives. The regions selected as designated areas are subject to change as their economic fortunes change. At present, the designated areas include all of Manitoba, Saskatchewan, and the Atlantic Provinces, all of Quebec except the Montreal-Hull corridor, a large part of Northern Ontario, and some slow-growth regions in British Columbia and Alberta.

The program of financial assistance in designated areas is under the control of the Department of Regional Economic Expansion (DREE). DREE grants are available to most manufacturing and processing industries. The only industries not eligible for DREE grants are petroleum refining, certain parts of the pulp and paper industry, mining, and the growing or harvesting or extracting of natural products.

Specific Incentives Available. Three types of development incentives are available under the DREE program. If more information is needed than is contained in the following discussion, it can be obtained from:

Department of Regional Economic Expansion Incentives Division,
161 Laurier Avenue West,
Ottawa, Ontario K1A OG5

Nonrepayable Grants. Nonrepayable cash grants are provided for projects whose capital cost is $25,000 or more, but lower-cost projects will be considered if at least five new jobs are created. Eighty percent of the cash grant is paid when commercial production begins; the remaining twenty percent is paid within two and a half years in the case of an ordinary expansion or modernization or within three and a half years in the case of a new plant or expansion to produce a new product.

One of the conditions for a nonrepayable cash grant is that the applicant provides a specified amount of equity capital. For a new plant, the required equity is at least 20% of the existing facility and 20% of the approved new capital cost.

The amount of the cash grant is determined by a formula. Projects involving new facilities or expansions to produce new products with approved capital costs of less than $1.5 million, and which create

fewer than 100 jobs, are eligible for a grant of 25% of capital costs plus a percentage of approved annual wages paid during the second and third years of operation. The wage incentive does not apply to ordinary expansions or to modernizations; and, in such cases, the grant is only 20% of capital costs.

New projects that create over 100 jobs and with capital costs of over $1.5 million will be reviewed by an Incentives Advisory Board. The maximum cash grant for such projects is the lowest of:

1. 25% of approved capital costs and $5,000 for each direct job created.
2. $30,000 for each direct job created.
3. 50% of the capital employed in the operation.
4. 80% of approved capital costs.

If the new project is only a modernization or volume expansion, the cash grant will be the lesser of $6 million or 20% of approved capital costs.

Loan Guarantees. Companies that do not qualify for a cash grant and those that have obtained a cash grant but require further assistance may obtain a loan guarantee. A loan guarantee improves the security available to the lender and, presumably, increases the amount of the loan obtainable. The applicant must obtain the loan himself, and the Department charges a fee of 1% for the guarantee.

Only projects with a capital of over $100,000 are eligible for loan guarantees, which cannot exceed 90% of the total borrowed.

Provisional Development Incentives. Some cash grants are provisionally repayable under certain conditions. Such repayable grants may be offered where the projects involve an unusually high degree of risk. The repayment is usually contingent on the project's attaining specified levels of profitability and performance.

Industrial Research and Development Grants. Industrial research and development is federally supported by generous income tax allowances and by the grant programs discussed in the following paragraphs.

There are two main prerequisites to obtaining these grants: (1) the applicant company must demonstrate that it has sufficient funds to produce in Canada any new product resulting from its research; and (2) the company must be free of parent-company restrictions in trading with foreign countries.

Industrial Research Assistance Program (IRAP). This program provides a 50% sharing of personnel costs for the expansion or formation of an applied basic long-term research team. Details can be obtained from the:

Committee on Industrial Research Assistance
National Research Council
Ottawa, Ontario K1A 0R6

Program for Advancement of Industrial Technology (PAIT). This is a program to provide financial assistance for specific research projects. A company must request this assistance, and the project must involve a significant advance in technology and offer good prospects for commercial exploitation. If the project is accepted, PAIT will share 50% of the cost of a development program, including the cost of a pilot plant, special test equipment, prototypes, and a confirmatory market survey.

Industrial Research and Development Incentives Act (IRDIA). This program provides a grant of 25% of the increase in current expenditures in Canada for scientific research and development over the average of such expenditures during the preceding five years.

Together, PAIT and IRDIA can reimburse a company for 75% of its pretax dollar incremental cost for research.

Complete information about the various grants for research programs can be obtained from:

Program Office
Department of Industry, Trade and Commerce
112 Kent Street
Ottawa, Ontario

Programs for Export Market Development. Incentives designed to increase exports of Canadian products and services are discussed in the following paragraphs.

Program for Export Market Development (PEMD). A loan of 50% of the cost of certain expenditures to increase exports is available. Eligible costs include identification of foreign markets, attending trade fairs, bringing foreign buyers to Canada, and costs of studies and bid preparations on foreign capital projects. The loans are interest-free and forgivable if no business is developed. The loan applications are

simple forms, and they are normally processed by the government in three weeks or less. The office to contact is:

Program Office (Export Market Development)
Department of Industry, Trade and Commerce
112 Kent Street
Ottawa, Ontario

General Adjustment Assistance Program (GAAP). This program offers two types of loans to companies that cannot obtain funds from other sources:

1. Manufacturers seriously injured or under severe threat of injury because of import competition can obtain direct government loans.

2. Manufacturers who wish to improve their ability to compete internationally can obtain government-insured private loans.

If it is necessary to develop restructuring proposals to support the request for either type of loan, grants may be obtained of up to 50% of the cost of outside consultants employed for this purpose. For full information, contact:

General Adjustment Assistance Office
Department of Industry, Trade and Commerce
112 Kent Street
Ottawa, Ontario

Machinery Program (MACH). Most types of machinery and parts not made in Canada can be imported with remission of all duty in excess of $500. The remission of duty applies in full to all parts subsequently imported under the original application.

Contact: Machinery and Equipment Advisory Board
Department of Industry, Trade and Commerce
112 Kent Street
Ottawa, Ontario

Industrial Design Assistance Program (IDAP). This program provides cash grants for improving the design of an industrial or consumer product. The cash grant is for up to 50% of the industrial designer's operational and administrative costs.

Contact: IDAP Program Office
Department of Industry, Trade and Commerce
112 Kent Street
Ottawa, Ontario

Agricultural and Food Market Development Assistance Program (MDAP). Companies that are free to export a newly developed food or agricultural product can obtain cash grants for feasibility, development, and Canadian capability projects.

Contact: Program Division
Agricultural, Fisheries, and Food Product Branch
Department of Industry, Trade and Commerce
112 Kent Street
Ottawa, Ontario

Automotive Adjustment Assistance Program (AAA). This program seeks to provide financing to companies manufacturing automobiles or parts that need to increase either their fixed or working capital. The financing provided is in the form of last-resort loans at current interest rates.

General Comment on Federal Incentives. To obtain any incentive, there is a general requirement that companies act as "good corporate citizens." This is usually interpreted to mean that companies should develop exports without permitting noneconomic influences to hinder such development and, similarly, Canada's domestic economy should be developed to the maximum extent.

The Canadian government does not obtain or retain a vested interest in the information or inventions, whether patented or not, that are developed by a company with the aid of these incentives.

Finally, the prior discussion by no means exhausts the available incentives. Many incentives of lesser importance were not even mentioned. However, a lesser incentive may be just the right one for a specific company. Potential foreign investors must do a great deal of spade work in this area to insure that all possible incentives are examined.

Provincial Incentives. Utilizing incentives offered by the federal government usually does not preclude obtaining a provincial incentive. All provinces offer financial assistance for companies not in a position to borrow through normal channels. The assistance provided by the provincial agencies is of two general types:

1. Direct lending in which the agency extends credit to the business concern.

2. Guarantees of loans obtained from other sources. Both types of loans are generally at lower interest rates than can otherwise be obtained.

As is the case with federal incentives, those offered by the provinces are numerous and varied. The following is a brief outline of the aid offered by the provinces.

Alberta:

1. "Alberta Opportunity Company." Offers financing of up to 80% of total assets of a small business.

2. "The Local Development Company Act" provides loans for local companies expanding or developing new enterprises.

Contact: Alberta Department of Industry and Tourism
Centennial Building, Edmonton, Alberta

Manitoba:

"Manitoba Development Corporation" offers loans to manufacturing and processing industries. Repayment terms are designed to meet borrowers' ability to repay.

Contact: Chairman and General Manager
Manitoba Development Corporation
600 Power Building
428 Portage Avenue
Winnipeg 1, Manitoba

New Brunswick:

"New Brunswick Development Corporation" provides loans or loan guarantees on first mortgages of financed capital assets.

Contact: New Brunswick Development Corporation
P.O. Box 71
Fredericton, New Brunswick

Newfoundland:

"Industrial Development Loan Board" makes available direct loans or financial guarantees. Loans are normally for 10 years at 5% interest.

Nova Scotia:

Industrial Estates Ltd. offers long-term loans on 20-year first mortgages on 100% of the cost of land and buildings of secondary manufacturers, up to 60% financing of the cost of new machinery, and property tax reductions on financed sites.

Contact: Secretary-Treasurer and Chief Provincial Officer
Suite 1006
5161 Royal Bank of Canada Building
George Street
Halifax, Nova Scotia

Prince Edward Island:

The Department of Industry and Natural Resources provides direct loans or financial guarantees or equal financial participation with owner in industrial plants for processing agricultural, horticultural, or fisheries products.

Ontario:

"Ontario Development Corporation" offers interest-free forgivable loans, term loans up to 20 years at reasonable interest rates, and leaseback and rental arrangements. Loans vary from 50% to 90% of approved costs, depending on the location of the enterprise.

Of particular note is the Export Support Program, which is financed through the above corporation. This consists of a line of credit or a short-term loan for work in process, which is made available to finance exports of capital and consumer goods. A requirement of this loan is that the export be insured through the Export Development Corporation (see page 43).

Quebec:

"Quebec Industrial Assistance Act." Under this Act, Quebec has established a number of agencies to assist the thrust of the province towards a mixed industrial economy. Several of these agencies are worth investigating. One of them, the General Investment Corporation, concentrates on joint ventures with local or foreign industrialists who can provide technical competence and funds. Another, the Quebec Petroleum Operations Co., is a crown corporation established in 1969 to work alone or in association with other companies on all aspects of oil and gas operations from exploration to selling. SOQUEM and REXFOR are mining and forest industry equivalents, respectively, of the Petroleum Operations Co.

Contact: The Department of Industry & Commerce
Government of Quebec
710 Place d'Youville
Quebec 4, Quebec

Saskatchewan:

The "Saskatchewan Economic Development Corporation" provides loans of up to ten years on a first mortgage of fixed assets.

Under the "Industrial Incentives Act," loans are granted to a maximum of $5,000 for each new job created, or 20% of the capital cost of the expansion or industry development, or $300,000, whichever is less.

Contact: Industry Development Branch
Department of Industry and Commerce
Power Building
Regina, Saskatchewan

Both the federal and provincial governments require that their loans take precedence over all other loans (mortgages) the company has outstanding, and the provincial agencies may also require that wages and salaries be frozen for a specified period of time.

Details of the federal and provincial programs may be obtained by writing directly to the government concerned. Alternatively, foreigners can contact within their own country the Commercial Secretary in the office of the Canadian High Commissioner (Embassy) or the representatives in a Provincial Trade Office in several major cities.

THE AUTOMOTIVE TRADE PACT

The Automotive Products Agreement was signed by the President of the United States and the Prime Minister of Canada on January 16, 1965. This Agreement provides that cars and original equipment parts may be imported to the U.S. from Canada without duty. Canada also eliminated import duties on similar products but only on imports by qualified automobile manufacturers.

Under Annex B of the Agreement, the U.S. requires that 50% of the value of cars imported from Canada must be of North American (Canadian and U.S.) content. Thus, overseas producers wishing to establish production facilities in Canada are required to go beyond importing parts and assembling cars.

Under Article 11 (a) and Annex A of the Agreement, Canadian "qualified manufacturers" have duty-free entry to the United States. Qualified manufacturers are those who maintain the same ratio, or not less than 75%, of vehicles produced in Canada to sales in Canada as in the model year 1964, and also maintain a Canadian value added at least equal to the value added to vehicles of the same class in model year 1964. This safeguard was intended to establish a base level and allow Canada to concentrate on a few models, thus providing a longer production run of models destined for export. This second condition of the Agreement gave some protection for the Canadian manufacture of parts.

Tariff Item 950 (1 to 6) contains the Canadian regulations respecting entry of motor vehicles and parts into Canada. Tariff Schedules 692–05 and 692–10 of the U.S. provide for importation of motor vehicles and parts into the United States.

Investment Factors

SPECIAL INVESTMENT CONSIDERATIONS

Transportation. Canada is a very large country with a small population. Consequently, a major investment decision is whether to operate regionally or nationally. The population is heavily concentrated in Quebec and Ontario along the St. Lawrence Seaway, which is open from late March to mid-November.

Freight rates are lower for water carriers than for land carriers and are regulated by the Canadian Transport Commission in Ottawa. Taking advantage of the St. Lawrence's natural inland waterway and the close proximity of the large East Coast and Midwest markets of the United States, most of Canada's secondary manufacturing industry has concentrated on Ontario and Quebec.

Two railways, Canadian National (CN) and Canadian Pacific (CP), operate country-wide rail networks and a complete range of railway services including express, ferry boats, telecommunications, ships, piggyback/container services, hotels, trucks, and airlines. Other railway companies operate provincially and in some cases use the tracks and other facilities of the major railroads. Information on rates can be obtained by contacting:

Canadian National Railways, General Offices
935 La Gauchetière St. West
P.O. Box 8100
Montreal 101, Quebec
Attention: Rates Officer

CP Rail, Head Office
Windsor Station
Montreal 101, Quebec
Attention: Rates Officer

An agreed-charge rate system is sometimes used. This involves negotiated rates between shippers and the railways for a minimum period of one year. By guaranteeing a certain volume of rail traffic, the shipper may qualify for a lower-than-normal commodity rate.

Common carriers or for-hire methods of truck transportation serve practically all communities. A small number of Canadian carriers are licensed by both Canadian and United States transportation carriers to carry goods to and from the ultimate points in each country. Published rates can be obtained from the following Highway Carrier Publishing Bureaus:

Canadian Transport Tariff Bureau Association
555 Dixon Road
Rexdale, Ontario

Quebec Tariff Bureau Inc.
1259 Rue Berri
Suite 400
Montreal, Quebec

Western Transportation Association
1116 Centre Street North
Calgary, Alberta

Many carriers are not members of these associations and direct solicitation is required to obtain their rate schedules.

All scheduled airlines operating in Canada handle air freight (air cargo), air express, and airmail, as well as passenger traffic.

Air Canada and Canadian Pacific Air (CP) service the main domestic routes from coast to coast, while carriers such as Transair, Nordair, Eastern Provincial, Pacific Western, and Quebecair provide regional services. Canadian and foreign airlines have local offices in most Canadian cities. In most cases, "interline" air freight and air express rates are available. The headquarters of the major domestic airlines are located at:

CP Air
1900 Grenville Square
200 Grenville Street
Vancouver 2, British Columbia

Air Canada
Place Ville Marie
Montreal 113, Quebec

There is a movement at the federal level away from competitive principles contained in the Transportation Act of 1967 to greater regulation and government ownership of transport facilities.

Establishing a Business. Many foreign manufacturers enter the Canadian market by a series of actions that progressively lead to greater involvement. The usual sequence is export to Canada, Canadian assembly of imported parts, Canadian manufacture of certain parts, and complete manufacture in Canada. This approach is often followed by businesses that have a unique product. In the export stage, the market for the product is developed by Canadian wholesalers or distributors—usually in Ontario and Quebec, which are the major consumer markets. As the market develops, it is not uncommon for others to start importing the product and for price erosion to occur. To maintain profit margins, parts are imported for Canadian assembly. At this stage, a "made in Canada" status can usually be obtained, which creates a tariff barrier against imports of the finished product. Further cost savings may then be obtained by

Canadian manufacture of some or all parts. Finally, the product is changed from an imported specialty to a Canadian mass-produced product.

Another route used by foreign companies is the acquisition of established Canadian sales or distributing organizations. The advantage of this approach is the ready-made distribution system. The distributing organization benefits by a broadened product-line that can be marketed without necessarily increasing the number of sales persons.

Building Codes and Standards. There are no nationally adopted building codes or standards in Canada; each major municipality has developed its own. Nevertheless, under sponsorship of the National Research Council, a uniform set of National Building Codes has been developed, and these are gradually being adopted across the country.

The Canadian Standards Association (CSA), a membership organization dealing with safety standards, is supported by government, industry, and educational institutions. Requests for the development of safety standards are initiated by government and industry. The initial procedure by the CSA is to study the need, then establish a committee composed of manufacturers, users, and government. This committee then determines through testing procedures the safety standards to be adopted. These standards are published and sold to interested parties. Products for which there are safety standards must be tested for CSA approval before being marketed in Canada. Details can be obtained from the Canadian Standards Association, 320 Queen Street, Suite 2100, Ottawa, Ontario K1R 5A3.

Marketing in Canada. Marketing goods requires an understanding of the unique features of the Canadian market. Canadian business operates through a sophisticated distribution system because a large percentage of Canada's retail business is concentrated in relatively few national firms. The mobility of the small population has fostered the absorption of smaller businesses by the national organizations. This fact is critical to a foreign company that wishes to market a product in Canada. The food industry is a prime example of such concentration.

The general distribution of consumer and industrial products is similar to that of other developed countries. Of special interest to foreign investors are the regulatory procedures dealing with food and

drug products. Manufacturers of food and drug products in Canada must be concerned with the Food and Drug Act regulations. This Act is administered by the Health Protection Branch of the Department of National Health and Welfare, Brooke Claxton Building, Ottawa, Ontario. A copy of the regulations can be obtained from this office.

Because many other government agencies are involved in the manufacture and distribution of food and drugs, it is advisable to contact a local office of the Health Protection Branch. The Food and Drug Inspector will provide guidance about compliance with the regulations and will also provide access to other concerned governmental agencies.

Distribution of drugs is complicated by the various insurance schemes and bulk buying systems operated by the provincial governments. The manufacturing facilities of companies that sell drugs to hospitals and provincial governments must meet Canadian Government Specification Board Standard 74-GP-1.

"Drug substitution" also must be taken into account. This means that under certain conditions a pharmacist may substitute a lower-priced drug of equivalent quality for one that is higher-priced. To support this procedure, the Canadian Government runs a Quality Assessment of Drugs Program (QUAD). This is a voluntary program under which a manufacturer submits a drug for testing and the results are published in comparative form against brand name manufacturers' drugs. The published results are distributed to all provinces, hospitals, doctors, and pharmacists.

All provinces offer insurance plans covering the major cost of certain drugs. Information on the various insurance and drug purchasing plans can be obtained from the provincial health departments located in the provincial capitals.

Government Agricultural Policy. Canada's agricultural policies are flexible, particularly towards the United States, and tend to reflect economic conditions at any particular time. Current policies reflect Canada's protectionist stance towards its agricultural industry, in contrast to its general liberal free trade attitude.

PATENTS, INDUSTRIAL DESIGNS, TIMBER MARKS, COPYRIGHTS AND TRADEMARKS

Patents. Patent protection in Canada is particularly important. The Commissioner of Patents administers the Patent Act under the

jurisdiction of the federal Department of Consumer and Corporate Affairs. Canadian manufacturers are not likely to be interested in manufacturing any article that does not have patent protection.

Canada is a member of the "Paris Union," and foreign applications for protection may be entitled to the date priority of the original application afforded under the Paris Union. The Canadian patent application, however, must be filed within one year of the first foreign application. The foreign patent alone does not provide protection in Canada. More than 90% of Canada's patents are of foreign origin.

Basic revisions of Canada's patent laws have been recommended.

The term of a patent is 17 years. To obtain a patent, an inventor must apply to the Commissioner of Patents in Ottawa. There is a filing fee of $50 and a final fee of $100 on granting the patent. No annual fees are required to maintain the patent. It is necessary to submit a petition, duplicate copies of a full description (with claims) of the invention, and any drawings referred to in the description.

It is advisable to employ the services of a Registered Patent Agent. A register of such agents is maintained by the Patent Office. These agents are experienced in handling the application, in searching technical literature and patents to determine if the invention is already known, and are familiar with language used to describe the patent. The description must be understandable to any person skilled in the subject and must provide sufficient information to carry out the invention without recourse to the inventor. Most inventors need an agent's expertise to so describe their invention.

Each patent application is examined for novelty and legality. Scientific principles and foods and medicines obtained from chemical processes are not patentable, but the process itself may be patented. If others have filed for the same invention, conflict proceedings determine the first inventor. Applicants have the opportunity to amend unacceptable applications or to respond to objections raised by Examiners. Examiners do not determine the practicality of an invention, and the patent grant is not an official endorsement. Compulsory licenses may be granted for patents not worked in Canada within three years or if licensing terms are not reasonable or for similar reasons.

Section VI-(3) and (4) of the Patent Act covers compulsory licensing of patents for foods and medicines. While the license granted for a food invention is limited to the production or preparation of the food, the license granted for medicines is much broader. It covers the preparation, the import of medicines used in the preparation, and the import of the finished preparation.

The Commissioner of Patents is authorized to grant a license for a medicine and to fix the royalty for its use. The royalty set by the Commissioner is based upon making the medicine or food available to the public at the lowest possible price consistent with rewarding the patentee for the research leading to the invention. Current practice is to set the royalty at 4% of the selling price. Where a medicine is under New Drug Status, as defined by the Health Protection Branch, National Health and Welfare, a compulsory license will be granted.

In 1972–73, over 21,000 patents were issued. Patent applications are secret until issued. New patents are published every Tuesday in the *Patent Office Record.*

Industrial Designs. Industrial designs for the ornamentation of any manufactured article may be protected by registration. Only the author or the person for whom the design was made can apply for registration. Registration provides exclusive rights to the design for five years and is renewable for one five-year term. The initial fee is $5 and the renewal fee is $10.

The drawing and its description are filed with the Commissioner of Patents in Ottawa. A register of designs is kept in the coyright division of the patent office. New designs are examined for originality.

Timber Marks. Persons engaged in lumbering in Ontario, Quebec, and New Brunswick must register marks to distinguish their logs and timber within one month of engaging in the business. The application must include a drawing or impression and a description of the mark. A filing fee of $1 must accompany the application to the Commissioner of Patents.

Copyrights. The Canadian Copyright Act recognizes the exclusive right to reproduce original literary, musical, dramatic, and artistic works. Copyright protection is automatic for Canadians, for other British subjects, and for citizens of countries that adhered to the International Copyright Convention when the work was produced. Copyright protection is available for paintings, drawings, sculptures, engravings, photographs, books, maps, charts, films, encyclopedias, newspapers, reviews, magazines, lectures delivered mechanically (tape recorded), plays, architectural plans, etc.

Although it is not necessary to register a copyright to obtain protection, it may be advantageous to do so as registration provides

prima facie evidence of legal ownership. Copyright protection lasts for the author's lifetime plus 50 years. If the copyright holder fails to meet the reasonable requirements of the Canadian market, or if a work is not available to the public after the author's death, there are procedures for obtaining licenses to reproduce or exhibit the work.

Copyright applications are sent to the Commissioner of Patents on a prescribed form with a $3 fee payable to the Receiver General for Canada. Copies of the work to be copyrighted are not required and will be returned if sent. However, two copies of the first printing of every book issued in Canada must be sent to the National Library, Public Archives Building, Ottawa.

Trademarks. Registration of trademarks is advisable but not compulsory, except that articles containing precious metals or watch jewels must be registered to obtain protection. Certain symbols (i.e., the flag, Canadian crests of arms, deceptive marks) are prohibited by the Trademark Act. Marks that are confusing or similar to previously registered marks are not registerable. Trademark protection is for 15 years and may be renewed for an indefinite number of 15-year periods.

The trademark registration fee is $35 plus $25 to cover the costs of advertising for disclaimer purposes. The renewal fee is $35. Complete information may be obtained from the Registrar of Trademarks, Department of Consumer and Corporate Affairs, Ottawa.

FOREIGN TRADE REGULATIONS

Canada's plentiful natural resources and closeness to United States markets have made foreign trade significant; exports and imports each are between 15% and 23% of gross national product. One consequence is that Canada has been an advocate of liberal foreign trade policies and, as a member of the General Agreement on Tariffs and Trade (GATT), has participated in all rounds of tariff-reduction negotiations.

Tariff Structure. Canada uses its own tariff nomenclature, which is not based on either the Brussels system or the Standard International Trade Classification. The tariff may be classified as mildly protective, with three sets of rates.

British Preferential Rates. With some exceptions, British Preferential Tariff rates (BPT) are the lowest. They are applied to imports from

British countries (except Hong Kong). A further 10% discount is applied to goods shipped directly from a British port to a Canadian port without trans-shipment through a non-British port. The discount does not apply to goods on which the duty is below 16%, nor to goods on which the preferential rate is the same as the most-favored-nation rate.

Most-Favored-Nation Rates. These rates are usually higher than BPT rates, but lower than general tariff rates. They apply to imports from countries with which Canada has trade agreements and to British countries when these rates are lower than BPT rates. The most important trade agreement concerning the effective rates applied to imports from countries entitled to most-favored-nation rates is the General Agreement of Tariffs and Trade (GATT). The U.S. has most-favored-nation status. Many imports from the U.S. enter duty-free; duties tend to increase as goods become more highly processed. On processed goods from the U.S., the most frequent rates are between 15% and 20%. Lower rates may apply to goods not available in Canada.

Developing Country Rates. Since July 1, 1974, 120 developing countries qualify for special tariff preferences. Goods from qualifying countries obtain the lower of British Preferential Rates or most-favored-nation rates, less one-third. Such countries as Brazil, Argentina, Hong Kong, Singapore, and Mexico qualify as developing countries.

General Tariff Rates. These highest rates apply to imports from those few countries with which Canada has no trade agreements.

Basis of Duty Assessment. Import duties are assessed on fair home market value, which is basically the value at the time and place from which the goods were shipped directly to Canada, in similar quantities, and under competitive conditions. The duties may be specific, ad valorem, or a combination. Many of the 2,000 or so items in the Canadian tariff schedule are duty-free. In addition to customs duty, many imports are subject to a sales tax and special excise taxes.

Pricing Considerations. The basis of duty assessment in the preceding paragraph is actually the normal foreign selling price of the goods. To this are added the customs duties, and the cumulative amount may be subject to sale and excise taxes. Whether the cumulative results, plus markup and other costs, enable imports to be priced competitively in the Canadian market must be carefully analyzed.

Investment Factors

FINANCIAL SYSTEM AND CREDIT INSTITUTIONS

The Monetary System. Canadian currency is based on the decimal system, with the monetary unit being the dollar ($). The federal government has sole authority to coin money, and all paper money is issued by the Bank of Canada.

Exchange Control Regulations. Canada has no controls over the entry or exit of foreign currencies. Foreign capital is treated in the same manner as local capital.

Over the years Canada has implemented exchange control regulations whenever economic conditions indicated that such controls were necessary. On May 31, 1970, the Canadian government unpegged the dollar to allow it to seek its own level.

The Bank of Canada. Canada's central bank, the Bank of Canada, was established in 1935 by the Bank of Canada Act. It is entirely owned by the government, and its main function is to determine the supply of money and credit, a duty it accomplishes by controlling the assets and deposit liabilities of the banking system. This is done by requiring all banks to maintain certain reserves with the Bank of Canada. Although the Bank of Canada exercises overall control, the allocation of the available bank and other credit is left to the private sector. Each chartered bank competes for deposits and determines its loan and investment policies.

The Industrial Development Bank (IDB). The IDB is a subsidiary of the Bank of Canada that was incorporated by Act of Parliament in 1944. Its function is "to promote the economic welfare of Canada by increasing the effectiveness of monetary action through ensuring the availability of credit to industrial enterprises which may reasonably be expected to prove successful if a high level of national income and employment is maintained, by supplementing the activities of other levels and by providing capital assistance to industry with particular consideration to the financing problems of small enterprises."

The President of IDB is the Governor of the Bank of Canada. IDB has authorized capital of $75 million and may also raise funds by issuing bonds and debentures provided that total direct and contingent liabilities in the form of guarantees and underwriting agreements do not exceed ten times the aggregate of paid-up capital and reserve fund.

The IDB is active in providing credit to small and medium firms that cannot obtain private credit on reasonable terms. Most of its loans are to Canadian-owned companies, but it also finances foreign-owned companies. Most loans are under $100,000 and for a term of five to ten years. Branch offices are located in all major cities. IDB accepts any form of security—realty and chattel mortgages are the common forms.

The Export Development Corporation (EDC). The Export Development Corporation (EDC) is a Crown Corporation empowered by a federal statute. The forerunner to this organization, the Export Credit Insurance Corporation, was superseded by the EDC in 1969 to accommodate the growing needs of trade.

The facilities of EDC are not meant to subsidize exporters and the EDC does not provide services that are available through commercial banks and insurance facilities. The EDC performs the following financial functions that are not available through commercial banks because the risk element is considered too large.

1. Insures Canadian firms against nonpayment when Canadian goods and services are sold abroad.

2. Makes loans to foreign purchasers of Canadian capital equipment and technical services.

3. Guarantees financial institutions against loss on export transactions by financing either the Canadian supplier or the foreign buyer.

4. Insures Canadians against loss of their foreign investments from political actions.

The main tools available to satisfy the exporter's financial needs are supplied by the departments of Export Credits Insurance, Export Financing, and Foreign Investment Insurance. The last named is more limited in scope than implied by its name.

The head office is in Ottawa, and there are district offices in Montreal, Toronto, and Vancouver. EDC in other major centers is represented by the regional managers of the Department of Industry, Trade and Commerce.

Chartered Banks. Chartered banks are the only banks in Canada permitted to engage in the full range of banking activities. They are known as chartered banks because they operate under charters issued under the Bank Act. Canada has ten chartered banks: Bank of

Montreal, Bank of Nova Scotia, Toronto-Dominion Bank, Provincial Bank of Canada, Canadian Imperial Bank of Commerce, Royal Bank of Canada, Bank Canadian National, Mercantile Bank of Canada, Bank of British Columbia, and Unity Bank of Canada. The Bank Act regulates the internal operations of chartered banks as well as their relationships with the public, the government, and the Bank of Canada, and specifies the types of services they can offer.

Chartered banks engage in as wide a range of activities as do commercial banks in other countries. However, they are mainly short-term borrowers and lenders. Most short-term loans are in the form of demand loans based on annual lines of credit. As provided in Section 88 of the Bank Act, the usual security consists of accounts receivable and inventories. Some borrowers are required to maintain a minimum balance in their checking accounts. It is usual practice to charge interest monthly, based on the portion of the loan outstanding.

In special situations, banks, as part of an ongoing relationship with a company, may accept a "fixed charge" or "floating charge" debenture from a company. These debentures are actually medium-term loans. As security for the loan, the company pledges respectively specific assets and/or all fixed assets specified in total, including assets later acquired. As with a fixed charge security, the company cannot dispose of any assets specified in the floating charge debenture without the permission of the bank. The cost of preparing and filing a "floating charge" debenture ranges from $250 to $550, depending on the size of the loan. The cost of a debenture that includes both a fixed and a floating charge would be higher.

Canada's chartered banks are organized on a national branch system. The number of branches has increased over the years and now totals about 6,800 in Canada and about 300 abroad. Each branch offers a full range of banking services and is backed by the full resources of the bank it represents. Head offices confine their activities to the administration of national and international matters and to the management of the bank's portfolios.

In 1973–74, total assets of chartered banks were $92 billion, deposits were $65 billion and loans were $53 billion. The banks employed about 115,000, and there were over 25 million savings and other deposit accounts.

Banks are required to insure their depositors' accounts, and no chartered bank has failed since 1923. All personal accounts are insured up to $20,000 by the Canada Deposit Insurance Corporation, which reports to the Minister of Finance.

Provincial Savings Banks. Provincial government savings banks exist in Ontario, Alberta, and Quebec. These institutions were established under federal legislation and report monthly to the Department of Finance. They offer savings account and checking facilities but are not sources of business credit.

Trust and Mortgage Loan Companies. Trust companies and mortgage loan companies are registered with either the federal or provincial governments, and they operate under the relevant acts of the two levels of government. Although there are some differences between the acts, the broad lines of legislation are common.

The mortgage loan companies obtain their funds from deposits and by issuing debentures, and place most of their funds in residential mortgages. Both trust and loan companies offer personal checking accounts and time deposit accounts.

Trust companies carry on intermediary business similar to that of the loan companies, although placing less emphasis on mortgage lending and more on security investment. Trust companies differ from other institutions in having the right to act as trustee for property interests and to conduct other types of financing.

Credit Unions and Caisses. The purpose of credit unions is "to promote thrift by encouraging savings and providing loans to members who cannot get credit elsewhere or can get it only at high interest rates." Credit unions are important in small communities where they function to a large extent as local banks. Credit union operations differ according to local requirements. For instance, in Saskatchewan some 40% of their loans are to farmers for current operations and the purchase of equipment.

In Quebec, the Caisse Populaire is a special form of credit union and actually its forerunner. In contrast to the credit union where up to half the members may be borrowers at any one time, only 10% to 15% of caisses' members are borrowers. Caisses offer higher interest rates on savings accounts. As with members of credit unions, members of a caisse must hold shares in the organization; however, they are discouraged from holding large blocks of shares.

One of the largest pools of investment capital in Canada belongs to the Caisse de Dépôt et Placement du Quebec (Quebec Deposit and Investment Fund), which invests the money paid into the Quebec Pension Plan. Much of the money is put into government bonds (60%),

but it is also allowed to put 10% into conventional mortgages and up to 30% into shares of companies (maximum 5% per company).

Stock Exchanges. Public companies often obtain financing by issuing securities to the public. Foreign-owned firms have the same access to the securities markets as Canadian-owned firms.

Canada has five stock exchanges (Toronto, Montreal, Vancouver, Winnipeg, and Calgary), but only the Toronto and Montreal exchanges are national markets. The Toronto exchange is the fourth largest in North America.

Each province has laws that protect buyers and sellers by regulating the underwriting, distribution, and sale of securities in Canada. The regulations differ from province to province, with Ontario having the most stringent regulations. Most securities acts are administered provincially by a Securities Commission, under the Attorney General. The Provincial Securities Commissions have formed a national policy group, except for Newfoundland and Nova Scotia, which prepares legislation for all exchanges.

To sell securities, the underwriting company must have purchased a seat on the relevant stock exchange. A securities salesman must be registered by the Canadian Securities Institute, which requires passing a special course given by them. For national distribution, the preliminary prospectus must be filed with all provinces. The provinces communicate with the Securities Commission of the principal jurisdiction. The prospectus must also be filed with the designated exchange before the securities can be listed for trading. For a private issue, approval of only the Securities Commission is required. A copy of the Securities Acts and Regulations is obtainable from the Queen's Printer (the official bookstore) in each province.

Venture Capital. Venture capital, often referred to as seed money, is very difficult to find in Canada. One source is venture capital companies. However, most such companies prefer to invest in companies that are at the development or expansion stage rather than the start-up stage because of the greater risk at the start-up stage. Some venture capital companies will finance companies at stage zero (at start-up) and will back turn-around companies and acquisitions.

The services provided by venture capital companies complement those of the chartered banks, investment dealers, term lenders, and other recognized financial institutions.

canada

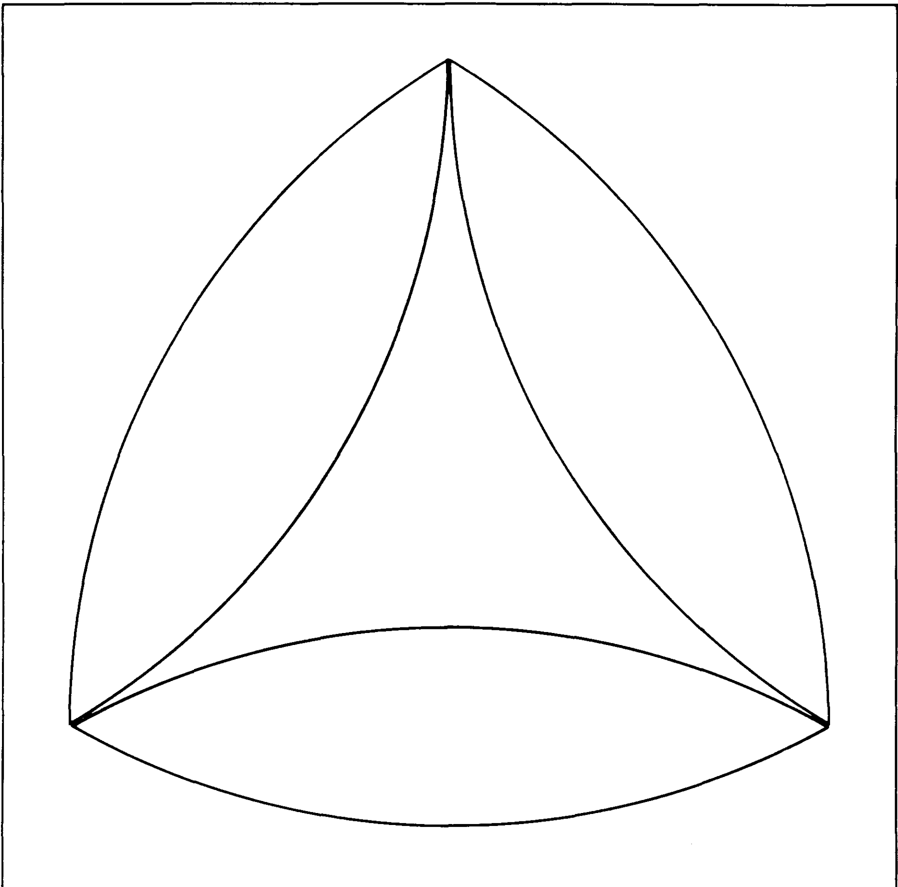
To assist entrepreneurs, the Canadian government has prepared a study of various sources of venture capital in Canada. This study, "Sources of Venture Capital," is available without charge at any government bookstore or from:

Information Canada Bookstore
Vanguard Building
171 Slater Street
Ottawa, Ontario K1A 0S9

CHAPTER III

Labor Conditions

The Canada Labor Code
Labor Standards
Health Programs and Fringe Benefits
Employment of Foreigners



Labor Conditions

Canada's rate of employment growth has been very fast, averaging about 3% a year. During the 1960s, the labor force increased by 30.6%, while women in the labor force increased by an unprecedented 62.3%.

The number employed reached record highs in the seventies. In February, 1974, the economically active population had reached 9.3 million. Of this number, 1.8 million were married wormen and 1.3 were unmarried women. The number of persons employed in agriculture ranges from 400,000 to about 550,000, varying with the season.

Despite Canada's impressive economic growth, unemployment, particularly on a regional basis, has been a continuing problem. Regional unemployment rates have been reasonably consistent over the years, as indicated in the following table:

	1962	**1967**	**1972**	**1973**	**1974(June)**
Atlantic Provinces	10.7	6.6	9.0	8.2	8.6
Quebec	7.5	5.3	8.3	7.4	6.2
British Columbia	6.6	5.1	7.6	5.6	5.3
Ontario	4.3	3.1	4.8	4.1	3.9
Prairie Provinces	3.9	2.3	4.5	4.6	2.1

Despite the relatively high national unemployment (4.9% June, 1974), there is a chronic shortage of skilled labor and professional people. The government assists by helping unskilled workers to attend trade schools and by assisting skilled workers affected by temporary or permanent dislocation to retrain. Should the planned investment by the chemical, steel, and related industries over the next 5 to 10 years be realized, there will be a need for all levels of labor in Canada, particularly in Ontario and Alberta. The lack of skilled people may be a bottleneck in Canada's planned industrial development.

Labor Law. The British North American Act of 1867 apportioned governmental powers between the central government and the provinces. Under this law, the federal government has jurisdiction over those employed in interprovincial and international transport and communications (i.e., railways, highways, pipelines, etc.). Each provincial government has legislative jurisdiction over workers within its boundaries who are not subject to federal law.

Government Employment Services. Employers can obtain assistance from government departments as follows:

Department of Manpower and Immigration – Provides data on labor supply and demand by industry and occupation.

Labor Conditions

Canada Manpower Centers – Provides a free employment service to employers and employees.

THE CANADA LABOR CODE

On July 15, 1973, the National Parliament enacted the Canada Labor Code, and several former labor acts were superseded. The Code consists of the following parts:

Part 1 – Fair Employment Practices
Part 2 – Female Employees Equal Pay
Part 3 – Labor Standards
Part 4 – Safety of Employees
Part 5 – Industrial Relations

Each part will be summarized briefly and compared with provincial legislation.

Fair Employment Practices. The Fair Employment Practices Laws prohibit discrimination in employment based on race, color, religion, or national origin. Amendments to include age, sex, and marital status among the grounds on which discrimination is prohibited are awaiting federal legislative action.

The Speech from the Throne in March, 1974 promised "amendments to the Statutes of Canada...for the purpose of providing equal treatment for women." The Canadian women's organizations do not exhibit the militancy of their United States counterparts; however, the promised changes could foster action programs by the various women's groups in Canada.

All provinces have adopted fair employment practices laws similar to those of the federal government. Ontario was the first province to prohibit discrimination on grounds of age, sex, and marital status. Quebec excludes employers with fewer than five employees from the provisions of its law.

Equal Pay For Women. Federally and in all provinces, legislation requires "equal pay for equal work," but it is questionable whether this has full effect. Women are also protected by legislation dealing with labor standards and human rights.

LABOR STANDARDS

Working Hours. The Labor Standards Code sets standards for hours of work, minimum wages, annual vacations, and holidays. The

standard work week is five 8-hour days with Saturday and Sunday free and a maximum of 48 hours a week. At least time-and-a-half must be paid for overtime and permits are required to work more than 48 hours. However, the law can be deferred or suspended where it can be shown that its application would be prejudicial to the employee or detrimental to the business.

The laws of Quebec, Nova Scotia, Newfoundland, New Brunswick and Prince Edward Island are similar to those on the federal level. The two territories (Northwest and Yukon) have a standard 8-hour day and 48-hour week, with a maximum of 10 hours per day and 60 hours per week. Two hundred and sixty hours are the monthly maximum. Permits and deferments for overtime work are obtained from the provincial Labor Departments.

Saskatchewan and Manitoba regulate the standard work hours through overtime pay regulations. Saskatchewan employers must pay overtime after 8 hours per day and 40 hours per week and Manitoba employers after 8 and 44 hours. Alberta and British Columbia set maximum hours at 8 per day and 44 per week while Ontario legislation provides for an 8-hour day and 48-hour week. In all provinces, daily working hours may be increased as long as the weekly maximums are not exceeded.

In practice, the average weekly hours worked in manufacturing are about 40. The average weekly earnings for all of Canada were $163.75 in mid-1973. The highest average weekly salaries were earned in British Columbia and Ontario and the lowest in Prince Edward Island.

Vacations. The annual paid vacation varies. Ontario requires one week the first year and two weeks in subsequent years, and in Saskatchewan an employee is entitled to three weeks after five years. Federal employees receive a two-week vacation with pay after one year of employment. The general practice is two weeks after one year of employment and longer vacations as the length of employment increases.

Holidays. Legal holidays vary from province to province and by industry. There are eight federally-designated national holidays observed in Nova Scotia; seven in Alberta, Ontario, and Manitoba; eight in British Columbia, Saskatchewan and the Northwest Territory; and nine in the Yukon (see Chapter 4 for the dates on which holidays fall).

Labor Conditions

Minimum Wages. Minimum wage standards increased significantly during the past year because of inflationary pressures. The situation by province is as follows:

Province	Minimum Hourly Wages
Newfoundland	$2.20
Prince Edward Island	$1.75
New Brunswick	$2.30
Nova Scotia	$1.80
Quebec	$2.15
Ontario	$2.25
Manitoba	$1.90
Saskatchewan	$2.40
Alberta	$2.00
British Columbia	$2.50
Yukon Territory	$2.40
Northwest Territories	$2.50

For federal government employees, the minimum hourly rate since April 1, 1974 has been $2.20.

The significant increases in minimum wages made by provincial governments reflect the fact that social welfare and unemployment benefits were higher than wages in some cases.

Wages and salaries actually paid vary across the country and within cities. For example, typical earnings in Toronto are:

Welder	$5.97 to $3.52 per hour
Laborer	$4.69 to $2.25 per hour
Secretary-Stenographer	$114 to $165 per week

Wage Protection. There is no federal wage protection legislation, and among the provinces only British Columbia has enacted a wage protection act, "The British Columbia Payment of Wages Act." This has recently been amended to make directors and officers of a corporation liable for the payment of wages. No other provinces have similar wage protection legislation. An effort by the Ontario government to legislate that wages owed should be paid before creditors in a bankruptcy situation was in conflict with the Bankruptcy Act.

Safety of Employees. The Safety of Employees Code regulates working conditions of employees in companies under federal jurisdiction. In the provinces, occupational safety is regulated by Workmen's Compensation Boards and Labor Departments through a

widespread system of standards and regulations. Employees who become disabled because of an employment-connected injury or illness are compensated. Using the Ontario Workmen's Compensation Act as an example of how the system works, compensation is paid from an Accident Fund that is administered by the Workmen's Compensation Board. All employers (but not employees) contribute to the Fund, so that no individual employer is liable for a compensation award. Legally, an employee cannot sue an employer in a situation in which the Workmen's Compensation Board is involved. The employer's contribution rate is partially based on his accident experience. The insurable earnings on which contributions are based range from about $3,000 to $9,000.

Certain employee groups are not covered by compensation awards. These may include farm workers; domestic employees; employees of nonprofit firms; and certain service, professional, and financial firms.

The compensation paid to disabled employees is generally about 75% of regular earnings, but subject to maximums. Life pensions are paid in cases of permanent disability and fixed monthly payments are paid to dependents in cases of death. Full medical care, without limitation, is provided to disabled employees.

Labor-Management Relations. The Canada Labor Code governs collective bargaining of employees under federal jurisdiction. The British North American Act grants to the provinces the right to enact labor legislation for employees under their jurisdictions. All of the provinces have laws governing collective bargaining. These laws guarantee freedom of association and provide the necessary machinery for collective bargaining to function.

About one-third of nonagricultural employees belong to labor unions. The Canadian Labor Congress (CLC) accounts for about 75% of total union membership. Most unions that are members of CLC are also affiliated with labor unions in the United States.

A union that obtains majority support has the right to provincial or federal certification as the bargaining agent for the unit, and the employer must bargain collectively with the union. Bargaining agreements are normally for two- or three-year terms. During the life of a labor agreement, most provincial laws require that any dispute be settled without recourse to a strike or lockout. Most provinces offer arbitration machinery if the parties to the dispute request it, and arbitration is compulsory in Ontario in such cases.

Labor Conditions

In many provinces, legislation has been enacted to prohibit persons providing essential services, such as police and firemen, from striking. In lieu of the right to strike, final and binding arbitration is available.

Most provinces require that a government-appointed arbitrator must attempt a settlement before a strike can be called. If he fails, a three-man board must attempt to settle the issues. And if the three-man board fails, no strike can be called until seven days after the board's report.

Time lost in work stoppages has varied over the years as follows:

	Thousand Man-Working Days
1971	2,867
1972	7,753
1973	5,769
1974 (9 months)	8,100

In some industries, the key labor demands have been wage parity with U.S. workers and a method of easing the burden for those technologically displaced. Because of inflationary pressures, the demand that wages automatically rise with increases in the cost-of-living index also has become important in labor-management negotiations.

Termination Notice. Federal regulations and regulations in seven provinces require employers to give notice to individual employees who are to be discharged. The federal law requires notice of at least two weeks. Notice required by the provincial laws varies from one to eight weeks—sometimes varying with the length of previous employment. Salary can be substituted in lieu of notice.

Other legislation requires advance notice to government authorities by companies in the event of mass layoffs, so that programs to assist the discharged employees can be formulated. Such legislation exists in Ontario, Quebec, Nova Scotia, and for employers under federal jurisdiction. This requirement also varies among the provinces. The most stringent requirement is in Nova Scotia where if 10 to 99 employees are to be dismissed within a four-week period, provincial government authorities must be notified eight weeks in advance.

Employers subject to federal law must also provide severance pay to an employee after five or more years of continuous employment.

HEALTH PROGRAMS AND FRINGE BENEFITS

Under the British North American Act, health and welfare matters are under the jurisdiction of the provinces. By collective consent of all provinces, certain health and welfare matters can be transferred to the jurisdiction of the federal government. Some have been transferred, some are under full control of the provinces, and some are provided jointly. Those under federal jurisdiction are old age security pensions, the earnings-related Canada Pension Plan (which includes retirement pensions, widows' benefits and disability benefits), family allowances, and unemployment insurance. Currently under provincial jurisdiction are medical plans, hospital plans, workmen's compensation, and various forms of supplementary assistance for the aged and others in need. The federal-provincial programs cover old age assistance, care of the blind, and unemployment assistance.

The fringe benefits customarily provided to Canadian employees are similar to those in other developed countries. Some, as indicated in the following discussion, are financed from general tax revenues and not directly by employers and employees.

Total Cost of Fringe Benefits. Over the ten-year period from 1963 to 1973, the average cost of fringe benefits, expressed as a percentage of gross payroll, has risen from 22.8% to 29.1% of payroll.

Ten-Year Comparison of Fringe Benefit Costs (as % of gross payroll)

		1973	1963
1.	Pay for time not worked:		
	Vacations	5.5%	4.5%
	Holidays	3.5	2.8
	Rest periods	4.2	3.4
	Other[1]	1.4	.9
		14.6	11.6
2.	Employee benefits[2]	9.8	7.2
3.	Payments required by law[3]	2.2	1.5
4.	Bonuses and profit-sharing	1.4	1.3
5.	Other items[4]	1.1	1.2
	Totals	29.1%	22.8%

Notes:

1. Bereavements, jury duty, etc.
2. Includes pension plans, death benefit plans, and disability income benefits.
3. Canada Pension Plan and unemployment insurance.

4. Severance pay, savings and thrift plans.

The major fringe benefit growth areas have been:

	Growth Over Last 10 Years
Payments required by law	47%
Employee benefits	36%
Pay for time not worked	25%

Canada Pension Plan. A compulsory Canada Pension Plan has been in effect since 1966 in all provinces except Quebec where the similar *Quebec Pension Plan* is in effect. Employees subject to these pension plans may also be covered by private pension plans.

Cost of Canada Pension Plan. Employers and employees must each contribute 1.8% of "pensionable earnings." For 1975, pensionable earnings are all earnings between $700 and $7,400. Thus, the maximum pension contribution by each employee is $120.60, an increase of $14.40 over 1974, and the same contribution is made by the employer. Self-employed persons contribute 3.6% of pensionable earnings.

Canada Pension Plan Benefits. After contributing for eight years, a worker retiring at age 65 in 1975 would receive up to $122.50 monthly, depending on previous earnings. This is in addition to social security benefits. The plan also provides benefits for children of disabled pensioners, widows and disabled widowers, orphans, and pays lump-sum benefits in case of death.

Pension benefits are automatically increased each January 1st if the cost-of-living index has increased. The Canada Pension Plan has been fully pegged to the Consumer Price Index since January, 1974.

Old Age Security Pension. The Old Age Security Plan that provides pensions at age 65 is supported by general tax revenues. Since October, 1973, the old age pension has been indexed with at least a quarterly adjustment. The pension increased October, 1974 to $117.02 from $112.95 a month to cover recent increases in the cost of living. The increase is the fourth since the old age pension was fully pegged to the Consumer Price Index in January, 1974.

Family Grants. The Canadian government pays grants to mothers on behalf of children. The monthly rate is $20 for each child up to 18 years, provided the youth does not earn taxable income. This

allowance is includable in income of the "breadwinner" of the family for income tax purposes. Quebec provides alternative allowances.

Medicare. The Medical Care Act provides that the federal government reimburse the provinces for one-half the cost of all health service plans that meet specified conditions. All ten provinces and the two territories provide comprehensive health care, although there are wide differences among the plans.

Ontario's Health Insurance Plan (OHIP) is typical in that it covers doctor services and hospitalization in a standard ward. The cost of the plan is:

Single person — $11.00 per month
Family — $22.00 per month

Major medical insurance is also offered in a variety of plans, but Ontario's Blue Cross is typical of direct payment plans:

Single person — $16.25 quarterly
Family — $28.50 quarterly

The cost of group-rate plans is considerably lower and is based on the size and composition of the group and the medical services selected for coverage under the plan.

Immigrants entering Ontario can obtain OHIP coverage from the first of the month following application. Visitors to Canada can be covered under a Blue Cross insurance scheme at the following rates for single persons:

21 days - $10.00
42 days - $18.00
63 days - $26.00
84 days - $34.00

Unemployment Insurance. With minor exceptions, employees are compensated when they are unable to find employment. This program is financed by employer and employee contributions. In 1974, employee contributions were 1% of earnings up to a maximum of $7.37 per month, and employer contributions were 1.4 times those of the employees. These rates change from time to time. Both employer and employee contributions are deductible for income tax purposes, and benefits paid to unemployed workers are taxable.

Unemployment insurance contributions are collected by the Department of National Revenue. Since this Department also handles pension plans and income tax withholding, a single remittance due on

the 15th of the following month serves all three purposes. Similarly, one payroll audit covers the three matters.

Employers must issue a separation certificate to any employee who suffers an "interruption of earnings" (not working and not paid for at least one week). Illness, maternity leave, injury, or quarantine are not interruptions of earnings.

Employers with insurable employees must register with the Unemployment Insurance Commission. Unemployment insurance benefits depend on earnings and length of employment.

EMPLOYMENT OF FOREIGNERS

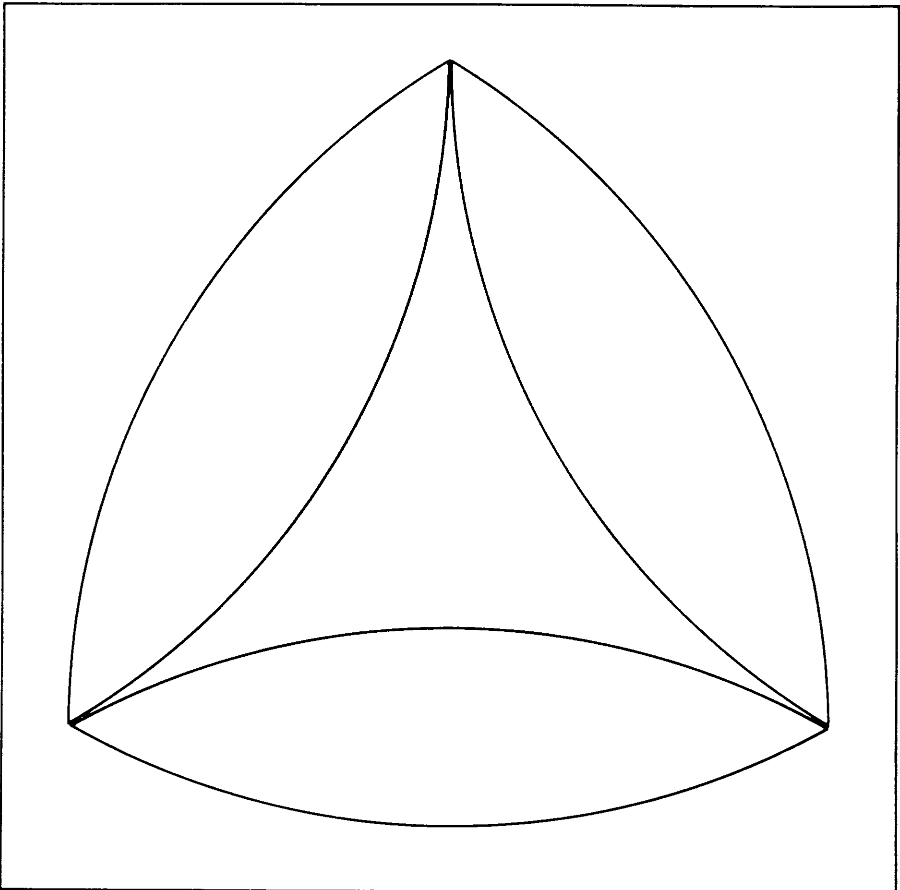
Canada has no legal limits on the nationality of employees. If a company wishes to send foreign supervisory or technical employees to Canada for other than very temporary employment, it is necessary to apply for landed immigrant status. The procedure for obtaining landed immigrant status is presently being studied by the federal government with the aim of increasing the labor force. The current system for potential immigrants is based on points for such factors as age, profession, skill, and ability with the English and/or French language. Two important factors in this system have been family ties and prearranged employment with a Canadian company. The government has announced regulations under which a definite job for which no suitably qualified Canadian citizen or landed immigrant is available has become a major criterion.

Landed immigrant status must be obtained abroad. An applicant in Canada with a visa of any kind must return to his original domicile. The proposed legislation is not meant to discourage skilled workers and professional persons from emigrating to Canada, but is designed to insure that qualified persons in Canada receive first preference for jobs. Information about how to obtain advance permission can be secured from the Department of Manpower and Immigration in Ottawa.

CHAPTER IV

Business Practices and Information

Business Hours
Communications
Travel Within Canada



Business Practices and Information

In general, business and social customs and practices are the same on both sides of the U.S.-Canadian border. U.S. advertising, television programs and, to a lesser extent, radio and magazines are ubiquitous in Canada and tend to reduce whatever differences exist.

Entry into Canada. Citizens or permanent residents of the U.S. do not require passports or visas to enter or leave Canada. However, it is necessary to provide evidence of U.S. citizenship or residency.

Visitors to Canada from other countries require their national passport and nonimmigrant visas from Canadian immigration offices. Visas are not required of citizens of countries part of the British Commonwealth, persons born or naturalized in any Western Hemisphere country, most European countries, and Turkey, Japan, and South Africa.

Automobiles are routinely admitted to Canada provided the motor vehicle registration identifies the driver as the owner of the car. If the vehicle is rented, the rental contract should stipulate use in Canada. Motorists are advised to obtain an insurance card from their own insurer as evidence of financial responsibility in case of an accident while in Canada. The card is known as "Canadian Non-Resident Interprovince Motor Vehicle Liability Insurance Card."

Health regulations vary and should be checked before starting the trip to Canada. At most entry points, Canadian health units can provide smallpox or other vaccinations on the spot.

Tobacco and Liquor. Visitors to Canada are allowed free entry with up to 50 cigars, 200 cigarettes, and two pounds of manufactured tobacco. Up to 40 ounces of liquor or wine are allowed.

A United States resident is allowed to return to the U.S. with up to $100 of Canadian merchandise, free of U.S. duties. This is allowed once every 31 days, provided the stay in Canada was at least 48 hours. Included in the $100 allowance are up to 100 cigars (non-Cuban) and 32 ounces of alcoholic beverages. For stays of less than 48 hours, no more than $10 of merchandise may be brought into the U.S., including no more than four ounces of alcoholic beverages.

Currency and Currency Exchange. Canadian currency is denominated in dollars and cents. Most hotels, restaurants, and stores accept U.S. money, particularly when both currencies are at par. However, since there often are differences in the exchange values, it is advisable to obtain Canadian currency at a bank and insure receiving

the proper exchange rate. Any amount of currency or travelers checks may be brought in or taken out of Canada.

Canadian currency is similar to U.S. dollar bills in size but each denomination has its own color. Canadian currency is issued in the following denominations:

Bills	Coins
$ 1	1 (cent)
2	5 (nickel)
5	10 (dime)
10	25 (quarter)
20	50
50	1.00 (silver dollar)
100	
1,000	

Holidays. Each province determines its own religious and other holidays. The provinces generally observe the federally-designated holidays and add one or two of their own. The following holidays are celebrated throughout Canada:

*New Year's Day	January 1
Good Friday (optional)	Friday before Easter Sunday
Easter Monday (optional)	Monday after Easter Sunday
Victoria Day	Monday before May 25
*Dominion Day (Canada's Birthday)	July 1
Labor Day	First Monday in September
Thanksgiving Day	Second Monday in October
Christmas Day	December 25

*If these holidays fall on a weekend, they are observed on the following Monday.

The traditional observances of some popular holidays have changed over the years. For example, Boxing Day (December 26) is observed by many businesses and factories but retail stores often remain open for special sales that draw large crowds. Banks and government offices close on Remembrance Day (November 11), but businesses in general are open.

Canadian Time Factors. Canada occupies seven time zones. Montreal and Toronto are in the same time zone as New York City, and other locations vary from one and a half hours earlier to four hours later than New York time. When it is 1:00 p.m. Pacific time in the United

States, the standard time in Canada's time zones is shown in the following table:

Yukon	12:00 noon	Eastern	4:00 p.m.
Pacific	1:00 p.m.	Atlantic	5:00 p.m.
Mountain	2:00 p.m.	Newfoundland	5:30 p.m.
Central	3:00 p.m.		

Daylight-Saving Time. Daylight-saving time, in which time is advanced by one hour, begins on the last Sunday in April and ends on the last Sunday in October. Nearly all communities are on daylight-saving time. The legislation is usually provincial, but municipalities also have an option.

Weights and Measures. Canada uses the imperial system of measurement, which includes the following:

yard	= 36 inches	gallon	= 160 ounces (compares with 128 ounces in the U.S. gallon)
pint	= 20 ounces		
quart	= 40 ounces		

The imperial bushel varies with the item being measured (60 pounds of alfalfa seed but only 34 pounds of oats).

The Minister of Industry, Trade and Commerce has stated that conversion to the metric system is an objective of Canadian policy, and schools are teaching the metric system. No timetable for conversion has been set. One of the factors is the timetable for U.S. conversion, which is not known. When Canada does convert, it will be to the International System of Units known as SI, in which multiples and submultiples of the measurement units are logically related based on powers of 10. The anticipated change is receiving increasing attention.

Language. Canada's official languages are English and French. English is in general use everywhere except the province of Quebec where the majority speaks French. Although it would be helpful for a visitor to be bilingual in Quebec, many people also speak English. Nevertheless, a knowledge of French or even an attempt to speak French is greatly appreciated. Information announcements in many types of public transportation are made in both English and French.

Outside of Quebec, most companies print labels, product instructions, etc., in both languages, but street signs, menus, newspapers, and so forth are usually only in English.

Business Practices and Information

Electric Current. Throughout Canada, the electric current provided is 100–120 volts, 60 cycles. Electric plugs and outlets are two-pronged.

Tipping. Tipping is common in restaurants, hotels, airports, taxis, beauty parlors, and barber shops. A common practice is to tip porters and bellboys 25 cents per bag. Taxidrivers, waitresses, and bartenders are usually tipped 10% to 15% of the bill. Tipping of chambermaids is optional.

BUSINESS HOURS

Business Offices. Traditional business hours are 9:00 a.m. to 5:00 p.m., but in Montreal and Toronto, work hours are being staggered to relieve the strain on the public transit system.

Government Offices. Government offices are usually open from 8:30 a.m. to 4:30 p.m.

Banks. Banks in suburban shopping centers are usually open during normal store hours. Downtown banks are open late on Thursday and Friday evenings to accommodate business people. Trust companies are open on Saturday, and many neighborhood banks are remaining open on Saturday to compete with the trust companies.

COMMUNICATIONS

Telephone Service. Telephone service is efficient and widespread, with about 11 million telephones in use. Canada's long distance rates are the lowest among developed nations.

Pay telephones are widely available. Local calls are twenty cents, and the coins must be inserted before dialing.

Long distance calls to the U.S. can be dialed throughout Canada. Calls after 6:00 p.m. and all day Sunday are less expensive. The lowest rates are available from 11:00 p.m. to 6:00 a.m.

Cable Service. Cables can be sent from any post office or may be sent by telephone. Incoming cables are delivered by the Canadian National Railways or Canadian National Telecommunications, and are often telephoned for quicker delivery.

Postal Service. Canadian postage stamps must be used on all mail posted in Canada. In cities, the main post office is usually open from 10:00 a.m. to 6:00 p.m. A new system assures next-day delivery of

letters placed in the proper mailboxes. The stripes on the mailbox indicate pickup and delivery times. Postage rates start at eight cents per ounce for mail within Canada and fifteen cents per ounce for airmail to all countries except the United States, which costs ten cents for one ounce.

Radio and Television. The Canadian Broadcasting Corporation, a government agency, operates the major French and English networks, and two privately-controlled networks also exist. The Canadian Radio and Television Corporation, a regulatory body, licenses all networks and several hundred privately-owned stations that serve local communities. The privately-owned stations cannot be controlled by non-Canadians.

TRAVEL WITHIN CANADA

Air Travel. Two major domestic airlines, Air Canada and Canadian Pacific, provide flights to all major areas in Canada, and smaller airlines link up to smaller cities. Flights to major cities are frequent, but flights to the smaller towns are infrequent.

Railways. Most cities and towns are served by the Canadian National or Canadian Pacific Railways. Both railways provide good service, including modern sleeping, dining, bar, and observation cars. A number of smaller railroads serve smaller areas.

Auto Travel. Car travel is fast and easy. Roads are good, and the main highways by-pass the smaller towns. The Trans-Canada Highway runs 5,000 miles and links the Atlantic and Pacific Coasts. Driving licenses from any state in the U.S., from other countries, or an international driver's license are valid in Canada.

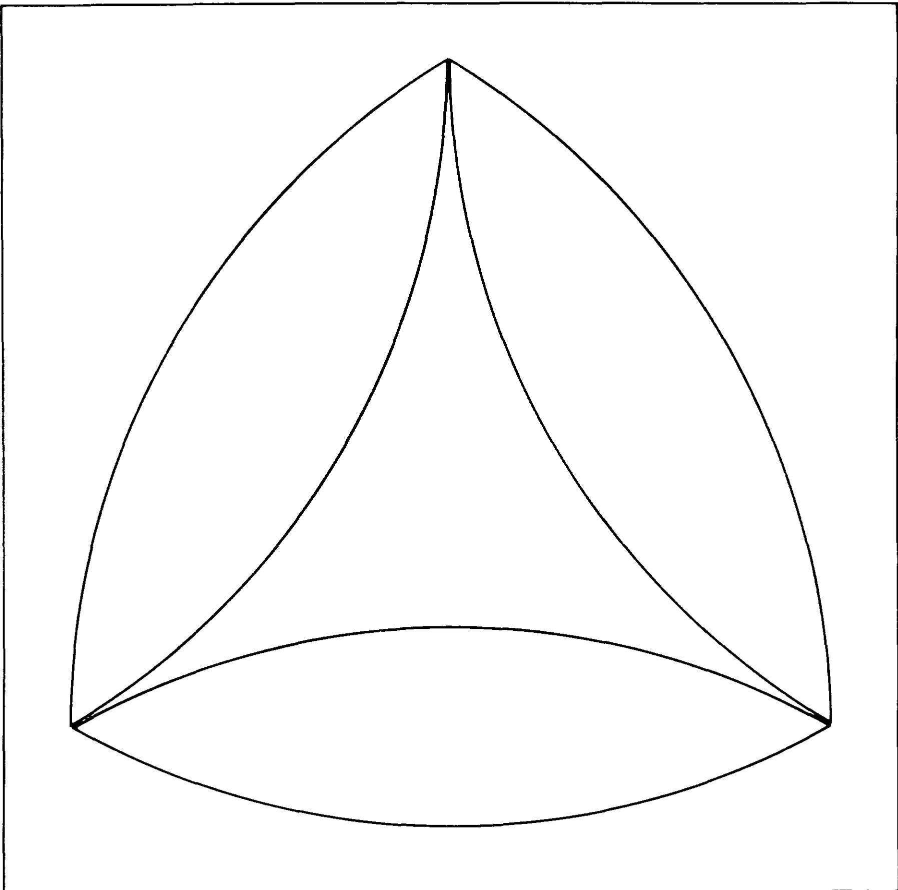
Canadian speed limits vary from 50 to 70 miles per hour on highways. Traffic moves on the right side, as in the United States.

Auto Rentals. Car rentals are available at standard prices, varying with the type of car and the season. Most car rental companies provide for cars to be rented in one city and returned in another.

CHAPTER V

Forms of Business Entities

Partnerships and Sole Proprietorships
Branch of a Foreign Corporation
Corporations
Operation of a Corporation
The Directors
Information Returns
Corporate Changes



Forms of Business Entities

Jurisdictional Background. As has been noted, the federal government and each of the ten provincial governments have their own rights, responsibilities, and laws. Each government has jurisdiction over matters pertaining to trade and commerce and industry generally, and the overlapping of jurisdiction is particularly visible in this area. Partnerships are registered under and regulated by provincial laws. Corporations may be incorporated under either provincial law or federal law but may find that their operations are governed by a combination of both. The Foreign Investment Review Act of the federal government and both federal and provincial legislation providing for incentive grants also help to complicate the picture. Anyone intending to set up an enterprise in Canada needs the help and advice of an experienced lawyer and of a chartered accountant and possibly of other consultants before deciding about such matters as the form of business entity, the location, the jurisdiction of incorporation, and the method of financing.

While there are many differences between the legislation of each province and of the federal government affecting business, they are often minor. This chapter therefore will discuss the subject of business entities from a broad point of view, but some of the major differences will be noted from time to time.

Forms of Business Entities. For the most part, business in Canada is organized in one of the following forms:

1. Partnership or sole proprietorship
2. Branch of a foreign corporation
3. Corporation

Entities such as cooperatives, mutual companies, nonprofit organizations, producers' associations, and trading associations are not in the mainstream of business and will not be described here. The legislation governing the incorporation and operation of banks is not discussed because the organization of banking enterprises is very restricted. There are only ten banks; foreign investment in them is restricted to a small percentage of each company's shares, and incorporation requires a special act of the federal parliament, which is a very lengthy and uncertain procedure.

Joint ventures are frequently organized, usually to engage in a specific enterprise. These, however, are by nature partnerships of persons or corporations, or a combination of the two, and the following discussion of partnerships applies also to joint ventures.

Forms of Business Entities

PARTNERSHIPS AND SOLE PROPRIETORSHIPS

Much commerce in Canada is carried on by partnerships and single proprietorships. This is especially true of almost all professional organizations and extends to trading and industrial enterprises, but in the latter cases is usually confined to the smaller entities. As the enterprise becomes larger, the advantages of limited personal liability make the incorporated company more attractive. Partnerships are under provincial jurisdiction but, generally speaking, the legal requirements and regulations are quite similar from province to province.

Limited Partnership. In most provinces, a partnership has a choice of being organized as either a general or a limited partnership. A limited partnership must have one or more partners whose liability to the public is limited to the extent of the capital contributed to the partnership. A limited partner may share in the profits but must take no active part in management. Any partnership wishing to establish and maintain limited partners should consult a lawyer about the declarations to be filed and the form of limitation on the limited partners' actions.

Risks of Partnership. Except for limited partners, all partners are general partners and as such are jointly and severally liable for the debts of the partnership. Furthermore, each general partner can bind the partnership irrespective of the consent of the other partners. This means that the general partners of an enterprise in financial difficulties may be called upon to meet its debts even to the extent of all their personal assets. It is for this reason that larger and high-risk organizations and even many smaller ones usually incorporate.

Partnership Registration. Partnerships must be registered with the proper provincial authorities. Failure to register may subject the partnership to a fine and may disqualify a partnership from collecting its receivables through legal process. In addition to registration of the partnership, certain types of business require licenses or permits to operate. For example, accountants, optometrists, morticians, and many other businesses must obtain a license from the appropriate provincial authorities.

Partnership Agreement. Each partner usually signs an agreement covering such matters as purposes of the business, name under which it will be conducted, place of business, capital contributions by each partner, division of profits and losses, rights of management, and

procedures for terminating or reorganizing the partnership. The partnership name can include "and Co." or "and Company," but words such as "limited," "incorporated" or their abbreviations are not permitted.

Although a written agreement is not required by law, it is very important in practice. The law specifies in some detail several matters such as the rights and duties of partners, the circumstances which may result in dissolution of the partnership and the position of partners after dissolution, but these matters may be (and very often are) varied by agreements between the partners. Unless the agreement is put into writing, proof of intent to depart from any of the statutory provisions may be difficult to establish.

Sole Proprietorships. Unlike a partnership, very little formality is required to set up and operate a sole proprietorship. Proprietorships are under provincial jurisdiction, but anyone capable of entering into a binding agreement can engage in any lawful business activity as a sole proprietor as long as he observes the general legal principles governing persons, property, and obligations. As in a partnership, it may be necessary to obtain a license or permit for certain types of businesses.

If an individual wishes to use a distinctive name other than his own, or to add "and Company" or similar words to his own name, he must file a declaration with the appropriate government authority in the province in which he operates.

BRANCH OF A FOREIGN CORPORATION

A branch of a foreign corporation is (with some exceptions — banking, for instance) free to operate in Canada subject only to the restrictions and requirements that may be imposed on any business entity. Thus, a branch must be licensed or registered in each province in which it wishes to carry on business, it must keep proper accounting records, and if it is subject to Canadian income tax (see Chapter 7), it must file its own tax returns.

A number of foreign corporations operate through branches in Canada, but a large majority have found it preferable to operate through incorporated subsidiaries. Even though a branch organization may escape some of the recurring costs to which an incorporated entity is subject, it also misses some of the important intangible benefits of Canadian incorporation, such as:

1. Closer identity with the Canadian business world.

2. More flexibility in dealing with Canadian people and problems.

3. A better structure for making decisions that reflect Canadian business realities.

4. Employee satisfaction in working for a Canadian organization even though it be foreign-controlled.

Liability of the Foreign Corporation. In every province, all creditors, employees, and third parties with claims against the branch may look to the total assets of the foreign corporation in settlement of liability arising from all acts and debts contracted by the branch managers, agents, or representatives. This liability is enforceable through the requirement that a resident of the province be granted a power of attorney to accept service of process on behalf of the foreign corporation.

CORPORATIONS

The principal form of business organization in Canada is the corporation — also known as a company. A corporation may be incorporated under the corporations act or the companies act (the names vary) of the province in which it is located, or (regardless of location) under federal law. The relevant act governs a corporation from cradle to grave and, among other things, specifies the rights and duties of the corporation, its directors, its shareholders, and its auditors, and specifies the nature and content of the corporation's financial statements. The various acts are similar but not identical; and since penalties for breaches of the law can be severe, it is important that directors of a corporation be familiar with the relevant act.

Proposed Federal Legislation. References in this Chapter and in Chapter 6 to the Canada Corporations Act (the federal act under which companies may be incorporated) are based on existing law. A bill has been introduced into Parliament, however, that would establish a new act — the Canada Business Corporations Act. The new act will be similar in many ways to those of Ontario and British Columbia, but because the provisions of the bill are subject to amendment as it is studied by Parliament, those proposals are not discussed here. The act is expected to become law in 1975.

Public and Private Companies. A corporation may be either "public" or "private." These terms and the meaning ascribed to them are not found in all the companies acts, although the underlying concept is provided for in each jurisdiction. The main distinctions

between the two forms are that private corporations are not allowed to offer their capital stock, bonds, or debentures to the public; the right to transfer capital stock is restricted; and the number of shareholders, not including employees, is limited to 40 or 50. The main advantages of a private corporation are that it is not subject to the securities legislation and under most, but not all, jurisdictions it is not required to make public any financial information.

Securities Legislation. Each province has enacted securities legislation to regulate the issue and trading in corporate securities within its jurisdiction. This legislation applies to all corporations whose securities are traded within the province and not merely to those incorporated under the laws of the particular province. Thus, for example, a company incorporated under federal law and offering its securities in Quebec, Ontario, and British Columbia must have regard for all four statutes. Because the federal government lacks constitutional power to regulate trading within a province, there is no federal legislation governing securities trading.

Besides regulating the security exchanges and the brokers and dealers trading securities within the province, the legislation regulates the sale of securities to the public by requiring the filing of a prospectus and compliance with extensive rules regarding the form and content of financial statements and other information included in the prospectus. The legislation also requires public disclosure of insider trading in securities, sets rules that must be followed in connection with takeover bids and proxy solicitations, and contains detailed requirements regarding the form and content of financial statements (both annual and interim). The financial statement requirements are similar to those imposed by the corporations acts but are more extensive in certain areas.

Severe penalties are imposed for breaches of the securities legislation. In Ontario, for instance, fines of from $2,000 to $25,000 may be levied, depending upon the nature of the breach, and imprisonment for not more than one year may also be imposed.

Licensing by the Provinces of Extra-Provincial Companies. Companies incorporated under any of the provincial corporations acts must be licensed or registered in any other province in which they wish to carry on business. (Under a reciprocal arrangement, Ontario and Quebec do not require a company incorporated in one of the two provinces to be licensed to carry on business in the other province.) On the other hand, a company incorporated under federal law is entitled to do business in any province without license or registration. Federal or

extra-provincial corporations are, however, usually required to obtain licenses to hold land, and are subject to provincial regulation in other respects.

Incorporation Procedures. Although the procedures differ from one jurisdiction to another, for all practical purposes the results are very similar. In each case, specified documents (an "application for a charter," a "memorandum," "articles" — the terms vary) must be filed with the designated Minister of the Crown. Provided the objects of the company are legal, the name of the company is acceptable, all papers are in order, and the proper fee is paid, a charter will be issued. The elapsed time between application and grant of the charter is normally not more than a few weeks. In fact, it is common to receive early informal approval of the application with advice as to the date the charter will bear. In these circumstances, it is in order to proceed as though incorporation has taken place even though the actual charter will not be received until later. The term "charter" is used to designate the documents constituting evidence of incorporation. Depending on the jurisdiction, these may take the form of "letters patent" (a charter issued under seal in the name of the Crown) or of a certificate of incorporation.

Capital Stock. A company's charter may authorize one or more classes of the following types of capital stock:

1. Common shares, with or without par value.

2. Preferred shares. These may also be with or without par value, although commonly they have par value. Preferred shares may have a wide variety of rights and privileges such as dividend preferences, redemption of principal at a premium, priority over common shares in the return of capital on winding-up, conversion into common shares, or restrictions on voting rights.

Costs of Incorporation. The incorporation fee payable to the government depends on the amount of the authorized capital stock. Under the federal act (the Canada Corporations Act) the fees are as follows:

Authorized Capital	Fee
Up to $50,000	$150.00
Each $1,000 additional up to $200,000	1.50
Each $1,000 additional up to $500,000	.75
Each $1,000,000 additional	.25

To calculate incorporation fees, shares with a par value of less than $.50 or with no par value are deemed to have a par value equal to the

consideration to be paid for them or $.50, whichever is greater. Fees under the provincial acts follow a similar pattern but are usually slightly lower.

Note that the above fees are for authorized capital stock. Not all authorized shares have to be issued at the time of incorporation. However, because of the minimum fee, many companies incorporate with the authorized capital covered by that minimum fee ($50,000 under federal law), issue as many shares as necessary, and retain the balance for issue at some later date. The company may apply at any time for an increase in its authorized capital.

The legal costs involved in incorporation vary, of course, according to the circumstances. Although the legal fee for obtaining a charter may be as low as $400 or $500, the fee will increase depending upon the complexity of the organization, its capital structure, its bylaws, the possible need to register the corporation in several provinces, and other similar matters.

OPERATION OF A CORPORATION

The relevant legislation has certain minimum requirements regarding the organization and operation of corporations. These may be broadened but not lessened by the company's own bylaws. For instance, among other things a federal corporation must:

1. Have at least three directors, each of whom must own at least one share. One of the directors must serve as president unless the corporation's bylaws provide otherwise.

2. Carry out its daily operations through duly appointed officers.

3. Hold an annual meeting of shareholders at which audited financial statements must be presented.

4. Keep adequate books of accounts and certain other specified records.

These matters are discussed in more detail in the following paragraphs and in Chapter 6.

Meetings of Shareholders. Each companies act provides that a company must hold an annual meeting of shareholders. The date of the meeting is fixed by reference to the date of the preceding annual meeting; requirements vary from one jurisdiction to another but, generally, no more than fifteen months may elapse between one annual meeting and the next. Usually, shareholders' meetings must be held in the place where the head office is located, but the bylaws, and in some cases a resolution of the directors, may state otherwise. A

company incorporated in British Columbia must hold its meetings within that province unless the company obtains permission from the appropriate government department to hold the meetings elsewhere.

Common shareholders generally have one vote for each share owned. Preferred shareholders may or may not have voting rights depending upon the terms of the issue. Voting by proxy is permitted in most cases.

The annual meeting must cover at least the following:

1. Presentation of the financial statements for the preceding year, approved by the directors, together with the auditor's report.

2. Election of directors — the term of office is usually one year but if the company's bylaws so provide the term may be up to five years, with some of the directors coming up for election each year.

3. Appointment of auditors for the ensuing year.

Special meetings of shareholders may also be called by the directors or on the petition of a group of shareholders (normally representing not less than ten percent of the voting shares) to deal with any matter affecting the company.

Books and Records. A federal company must maintain the following records (usually at its head office):

1. A copy of the letters patent, any supplementary letters patent, and other documents concerning the incorporation of the company.

2. A copy of all bylaws and resolutions.

3. A register showing the names, addresses, and callings of all past and present holders of the company's securities.

4. A register showing the names, addresses,and callings of all past and present directors of the company, and showing the periods during which they held office.

5. A register showing the number of shares of each class owned by each shareholder, including all amounts paid and unpaid on the shares.

6. A register of share transfers.

7. Minutes of all proceedings at meetings of the shareholders and of the directors and of any executive committee.

8. Proper accounting records.

Certain of these records must be available for inspection by shareholders and creditors of the company.

The provincial acts have similar requirements regarding the books and records which are to be kept and their availability for inspection.

THE DIRECTORS

The affairs of a company are managed or supervised by a board of directors elected by the shareholders at the annual meeting. Casual vacancies usually may be filled by the board of directors but such appointees hold office only until the next annual meeting.

Qualifications of Directors. Some of the acts have certain residence or citizenship requirements. Ontario, for example, requires that the majority of directors be Canadian citizens ordinarily resident in Canada; British Columbia requires that at least one director be resident in that province. Under some acts, at least two directors of every public company must be persons who are not officers or employees of the company or of any affiliate of the company. No person may be elected as a director who is an undischarged bankrupt or has not reached the age of majority as defined by the relevant legislation (normally 18 years).

Standard of Care. Both the common law and the acts lay down the specific duties and responsibilities of directors, but recent legislation in Ontario and British Columbia has gone a step further and has defined the standards of care which a director must follow in meeting his responsibilities and duties. The following wording, which is found in the Ontario Business Corporations Act, is similar to that of British Columbia and is representative of standards that are expected to appear in other acts.

> "Every director and officer of a corporation shall exercise the powers and discharge the duties of his office honestly, and in good faith and in the best interests of the corporation, and in connection therewith shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

Under this same act, a director may be sued in a representative action brought by a shareholder on behalf of the corporation for breach of his statutory duty of care. If such action is sustained by the court, the director may not be indemnified by the company for any liability, cost, or expense he incurs in connection with the action. Furthermore, although the company may maintain insurance for the benefit of the director, it cannot cover a liability resulting from a breach of his statutory duty of care.

Duties of Directors. The specific duties of directors other than the general duty to manage or supervise the operations of the company include the following:

1. Appointing the officers of the company.

2. Authorizing the issue of capital stock.

3. Authorizing the transfer of shares (in a company where there is a restriction on such transfers).

4. Declaring dividends.

5. Enacting bylaws for approval by the shareholders.

6. Appointing committees charged with specific responsibilities (such as an audit committee).

7. Approving the annual financial statements for presentation to the shareholders.

8. If a casual vacancy arises, appointing an auditor who will hold office until the next annual meeting of the shareholders.

9. Taking whatever action may be necessary to fill any vacancies on the Board. In the absence of a quorum, it may be necessary to call an immediate general meeting of shareholders in order to fill the vacancies.

Meetings of Directors. Under most jurisdictions, the requirements for directors' meetings are laid down either in the bylaws of the company or by resolution of the directors themselves. The Ontario act, however, provides that in any financial year a majority of the meetings of the board of directors (and a majority of the meetings of any executive committee of directors) shall be held within Canada. The same act requires that a majority of the directors present must be resident Canadians to constitute a quorum, and also contains certain provisions whereby meetings may be held by means of a conference telephone.

Audit Committees. Under the laws of British Columbia and Ontario, the directors of a public company must elect annually from among their number a committee to be known as the audit committee which must be composed of not fewer than three directors, of whom a majority shall not be officers or employees of the company or of any affiliate of the company; this committee is to hold office until the next annual meeting of the shareholders.

The statutory duty of the committee is to review the annual financial statements of the company before they are submitted to the board of

directors for approval. In practice the activities of an audit committee may include the review of:

1. Nomination of the auditors.
2. The overall scope of the audit.
3. The results of the audit.
4. Internal financial controls.
5. Any financial information for publication.

An audit committee will usually meet with the auditors at least twice a year, but the law requires the auditors to appear before the audit committee whenever they are asked to do so. The law also gives auditors the right to attend any meeting or to cause a meeting of the committee to be held, if they consider it necessary. Many companies are appointing audit committees, even in jurisdictions where they are not required to do so.

INFORMATION RETURNS

Every company is required under various statutes to file returns either on specified dates or on the occasion of certain events. A company which carries on business in a number of provinces must file annual returns in each of those provinces. The information called for in these annual returns, although similar, is not identical in each jurisdiction and the filing dates themselves may differ.

Corporations and Labour Unions Returns Act. This is an important federal act which requires an annual return in addition to the returns required by the statute of incorporation. Generally speaking, it applies to any corporation, public or private, which carries on business in Canada and whose gross revenue exceeds $500,000 or whose assets in Canada exceed $250,000. Even a company that does not meet these criteria may be required to file if it is related through its management, ownership, or financial affairs to one or more companies which in the aggregate meet these criteria.

The annual return, which may accompany the company's federal income tax return or be filed directly with the Chief Statistician of Canada in Ottawa, falls into two sections;

Section A is available for examination by the public upon payment of a small fee and calls for the following information, among other matters:

1. The names, addresses, and citizenship of all directors, whether resident in Canada or not, and of all officers of the company who are resident in Canada.

2. The name and address of any corporation holding more than ten percent of the company's issued shares of any class and the number of shares held.

3. The ownership by any nonresidents of more than five percent of the issued shares of any class.

4. Particulars of any corporation authorized to do business in Canada in which the reporting company holds more than fifty percent of any class of shares.

Section B is a confidential return not available to the public which must give details of payments to nonresidents for interest, dividends, rents, royalties, advertising, research, insurance, management fees, fees for defined professional services, and salary and annuity payments to directors and officers. This must be accompanied by a copy of the company's annual financial statements and the auditors' report. Although this section of the return is confidential, a company's annual financial statements do become a matter of public record in certain circumstances which are discussed in Chapter 6.

CORPORATE CHANGES

After incorporation, the corporate organization may be changed, but the changes must follow the procedures laid down by the governing act.

Increases in Authorized Capital. As a company's needs for capital change or increase, it may increase its authorized capital stock and introduce other classes of shares with different privileges. There is usually no difficulty in obtaining such authority upon payment of the appropriate fee, provided an application is made in the required form to the designated authority.

Reductions in Issued Capital. All acts provide for the reduction of a company's issued capital, after application to the appropriate authority. The purpose may be to return to the shareholders any capital in excess of the company's present requirements, to eliminate an accumulated deficit, or in connection with a compromise arrangement with creditors. The authority will be granted only if the rights of creditors are fully protected. The reduction of capital is not a frequent occurrence.

Purchase by a Company of Its Own Shares. A company incorporated in Ontario or British Columbia may purchase its own common shares and later reissue them if the company's articles (charter) specifically authorize it to do so. Such purchase is prohibited if it should render the company insolvent.

Redemption of Preferred Shares. Under all acts, preferred shares with redemption privileges may be issued, and may be redeemed except if redemption would cause insolvency.

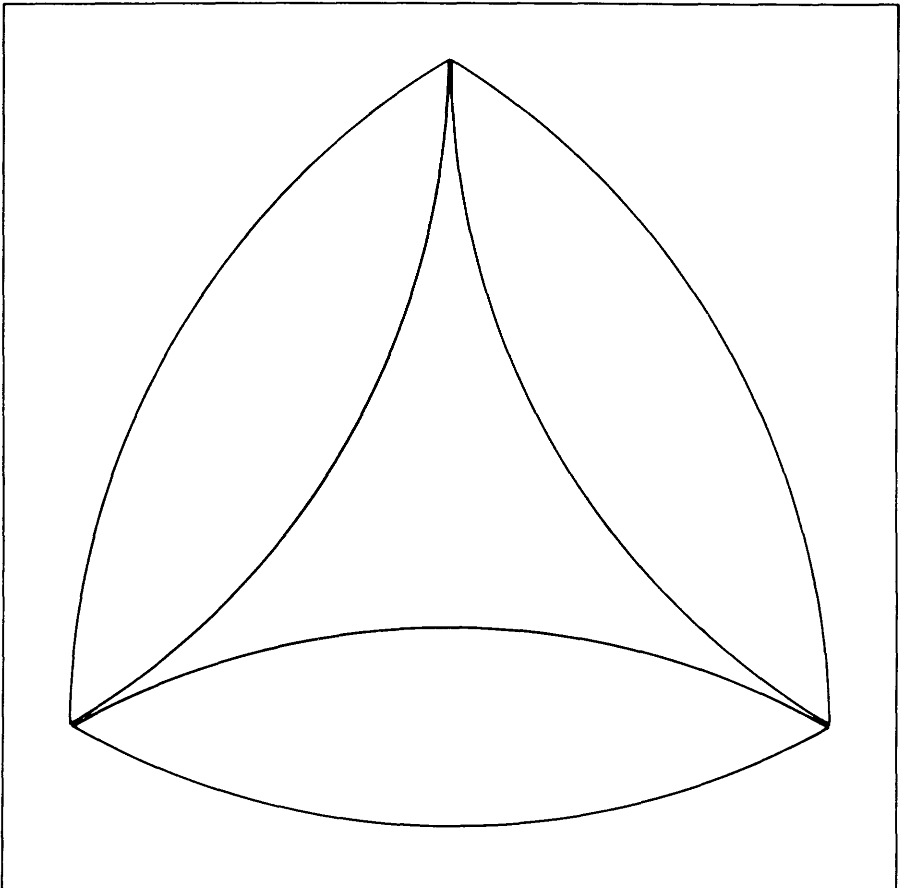
Amalgamations. Both federal and provincial acts provide for the statutory amalgamation of existing companies incorporated under the same act. The federal government and certain provinces have been considering the possibility of inter-jurisdictional amalgamations.

Dissolution. A company may be dissolved voluntarily either by surrendering its charter or by applying for a winding-up order from the court. It may also be dissolved involuntarily by court order under the Bankruptcy Act, or under the winding-up provisions of the Act under which it was incorporated, or under the Winding-Up Act in the case of a federal company. Federal companies may, in some circumstances, be dissolved for failure to file the required annual returns. In all cases of dissolution, the intent of the law is that shareholders do not receive any assets until all creditors have been paid in full, and that the legal preferences of creditors are observed in the distribution of assets.

CHAPTER VI

Accounting and Auditing

Auditing Standards
Legal Requirements Concerning Auditors
Legal Requirements as to Financial Statements
Canadian Accounting Principles



Accounting and Auditing

Accountants in Canada. The chartered accountant is preeminent in the public practice of accounting and auditing. Other bodies of accountants, notably the Registered Industrial Accountants (RIA) and the Certified General Accountants (CGA), are active but their members are mostly engaged in commercial and industrial accounting rather than in public practice. The following information about the accounting profession, therefore, deals principally with chartered accountants.

Jurisdictional Background. Under the Canadian Constitution, the regulation of the professions is a matter which falls within the powers of the provincial governments. The method of regulation varies, but in most provinces a person must obtain a license from a designated authority in order to practice public accounting. A chartered accountant in good standing automatically qualifies for a license; other accountants may be eligible for a license if they can provide evidence of adequate experience and technical ability.

Structure of the Chartered Accounting Profession. Following the constitutional pattern, each province has its own institute of chartered accountants—some of which were incorporated almost 100 years ago. These institutes are responsible for determining admission qualifications, admitting and registering students and members, arranging for or providing professional training for both students and members, setting standards of professional conduct, and disciplining students and members.

In 1902 the provincial institutes organized a national association now known as the Canadian Institute of Chartered Accountants (CICA), whose office is at 250 Bloor St. East, Toronto, Ontario. The Canadian Institute has no power to confer upon an individual the right to become a chartered accountant but a member of a provincial institute automatically becomes a member of the Canadian Institute. Similarly, if for any reason he should cease to be a member of his provincial institute, then he automatically ceases to be a member of the Canadian Institute. The ruling body of the CICA is a 23-member board of governors chosen by the provincial institutes and by the Institute of Chartered Accountants of Bermuda, which has recently become associated with the CICA. Although the authority of the CICA is derived from the provincial institutes, so many important duties have been delegated to it that its stature and importance have grown until in some respects it is viewed as the senior body. For instance, it is responsible for originating and promoting accounting and auditing research in Canada and for making authoritative pronouncements on accounting

and auditing matters; it represents the Canadian accounting profession on such international bodies as the Accountants International Study Group and the International Accounting Standards Committee; it collaborates with the provincial institutes in setting the body of knowledge which a student must acquire to become a chartered accountant, and by agreement with the provincial institutes it prepares and marks the uniform annual examinations for admission to each institute.

Two publications of the CICA deserve special mention. The "CICA Handbook" is a looseleaf book containing the Recommendations of the Accounting Research Committee and of the Auditing Standards Committee, which are referred to later in this chapter, and guidelines on accounting and auditing matters as well as background information on the organization and activities of the institute. This Handbook is published in both English and French. The CICA also publishes an influential monthly journal, the "CA Magazine," that focuses on a wide range of professional matters, and whose articles are in both English and French. At March 31, 1974, the CICA had 22,220 members, of whom approximately 10,480 were in public practice and 7,653 were in industry and commerce. On the same date, about 6,250 students were enrolled in prequalification studies.

Professional Training and Examinations. Prequalification training is controlled by the provincial institutes and (depending upon the province) may consist either of university courses or correspondence courses. The student must acquire the knowledge set out in the uniform examination syllabus adopted by the provincial institutes and published by the CICA, which comprises the following subject areas:

1. Financial accounting and reporting
2. Auditing
3. Professional practice
4. Managerial accounting and control
5. Specialized accounting
6. Computers and data processing
7. Taxation
8. Finance
9. Investigations
10. "Associated areas" (law, economics, management processes, and quantitative methods)

To be eligible for admission to a provincial institute, a student must complete a certain minimum period of practical experience in addition to passing the examination. The experience requirements vary from one to three years, depending upon the province. The admission requirements for qualified accountants from other countries vary according to the standing of the professional body to which they already belong, but each person seeking admission must demonstrate by examination a knowledge of Canadian law and taxation.

Information about training and eligibility requirements can be obtained from any of the provincial institutes whose addresses are obtainable from the Canadian Institute of Chartered Accountants.

Code of Ethics. Each provincial institute is responsible for setting and enforcing the code of ethics to be followed by its members. Although the provincial codes of ethics are not identical, in substance the same ethical standards are required of chartered accountants across Canada. An interprovincial committee is now working to produce a code to which all institutes would adhere, and a good deal of progress has already been made. The various codes deal with such matters as general standards of conduct, generally accepted auditing standards, independence, methods of practice, relations with clients, relations with employees, and relations with fellow members.

AUDITING STANDARDS

Canadian auditing standards developed on the foundation laid many years ago by practitioners who emigrated from the United Kingdom to Canada. More recently, partly because of extensive investment in Canada from U.S. sources, auditing standards have been influenced by those of the United States.

Canadian auditing standards are at present to be found in the Rules of Professional Conduct or Code of Ethics of each provincial institute of chartered accountants. Although the wording of these standards is not identical, for practical purposes in substance the standards are uniform across the country, and are very similar to those in the United States.

Specific recommendations of the Auditing Standards Committee of the CICA concerning auditors' reports and other auditing matters (such as required procedures for attendance at physical inventory counts and confirmation of accounts receivable) are to be found in the CICA Handbook. The Committee is working with the provincial institutes to seek agreement on uniform wording for generally accepted auditing standards for inclusion in the auditing section of the Handbook.

Accounting and Auditing

Form of Auditors' Report. Because of differences in the requirements of the various companies acts, a completely standard form of report for all jurisdictions is not possible. Nevertheless, the following form of auditors' report as suggested by the CICA meets the requirements of most acts and only minor modifications are necessary to comply with the requirements of some jurisdictions.

AUDITORS' REPORT

To the Shareholders of X Co. Ltd.

We have examined the balance sheet of X Co. Limited as at December 31, 197x and the statements of income, retained earnings, and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these financial statements present fairly the financial position of the company as at December 31, 197x and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

(Signed)..............................
Chartered Accountant

City: (Office location of auditors)
Date:

If the auditor is unable to issue an unqualified opinion, he must state his reservations clearly and give a clear explanation of the circumstances that prevent him from expressing an unqualified opinion or (if appropriate) why he is unable to furnish an opinion.

When an auditor is reporting on consolidated financial statements which include significant subsidiaries that he does not audit and with whose auditors he has no agency relationship, he must disclose in the scope paragraph of his report that he has relied on the reports of the other auditors. Similar disclosure is also required when he is reporting upon financial statements which include material investments accounted for by the equity method and he is not the auditor of the investee.

LEGAL REQUIREMENTS CONCERNING AUDITORS

Appointment of Auditors. The auditors are the representatives of the shareholders and the companies acts require that the shareholders shall at each annual meeting appoint one or more auditors to hold office until the close of the next annual meeting. If for any reason the shareholders fail to do this at the first annual meeting of the company, there is a legal requirement that the directors shall make the appointment; if at any subsequent annual meeting the shareholders fail to appoint an auditor, the auditor in office continues in office until a successor is appointed. Any casual vacancy in the office of auditor may be filled by the directors.

Under the Code of Ethics a chartered accountant is prohibited from accepting an appointment as auditor without first communicating with the auditor whom he is replacing.

The remuneration of the auditor is fixed by the shareholders, or by the directors if they are so authorized; normally, the directors of a company have this authority and are thus able to negotiate the fees of the auditors with a free hand.

Exemption from Audit Requirements. Some acts contain exemptions from the audit requirements if certain conditions are met. These conditions vary from one jurisdiction to another and are not reproduced here, but in general such exemption is available only to a small private company that is not a subsidiary of a company incorporated in another jurisdiction. Unless the relevant act provides for exemption and all the conditions are met, a company must appoint auditors. Conversely, a company that may be eligible for exemption but which appoints auditors should recognize that by its action it has appointed an auditor under the act and that the auditor has all the rights and duties prescribed by that act.

Eligibility for Appointment. Subject to certain independence requirements, a company may appoint as auditor any person authorized under provincial legislation to follow the practice of public accounting. The independence requirements vary from one act to another but, generally, no director, officer, or employee of the company or of an affiliate of the company may be appointed as auditor, and this restriction extends to partners, employers, and employees of such persons. Furthermore, no person may be appointed auditor if he or any partner or employee or person related to him owns directly, or indirectly, any securities of the company or of any affiliate of the company. These legal restrictions (which are particularly stringent

under the Ontario Act) should be read in conjunction with the independence rules imposed upon chartered accountants by the respective provincial institutes.

Duties of the Auditor. The auditor must report to the shareholders on the financial statements presented before the annual meeting, and must make such examination as will enable him to report in accordance with the requirements of the act. Most acts require the auditor to state in his report:

1. Whether in his opinion the financial statements present fairly the financial position of the company, the results of its operations and the changes in its financial position for the period under review in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period.
2. The reason for any qualified opinion in his report.
3. Such statements as he considers necessary if:
   a) the financial statements do not agree with the accounting records.
   b) the financial statements are not in accordance with the requirements of the act.
   c) he has not received all the information and explanations he has required, or
   d) proper accounting records have not been kept so far as appears from his examination.

It should be noted that in the absence of any statement referred to in (3) above, the auditors' report would be construed as giving a positive opinion on these matters.

Under the Ontario and British Columbia Acts, if the auditor learns from the directors or officers of the company (who themselves have a legal duty in this matter) any facts which could reasonably have been determined before the last annual meeting and which, had they been known at that time, would have required a material adjustment to the financial statements, the auditor must amend his report on those statements if he considers it necessary. The Ontario Act in particular places a heavy burden on the auditor as to the action he must take, regardless of the source of his information.

The auditor must also attend any meeting of shareholders when so required (in Ontario, any single shareholder may enforce such requirement), and if he is present at any meeting of shareholders he has a duty to answer inquiries directed to him concerning his report.

The auditor must also appear before any meeting of the audit committee when so required.

Rights of the Auditor. To balance the strict statutory duties of the auditor, the law accords him rights commensurate with those duties. These include the right:

1. To receive written notice of his appointment.

2. At all times to have access to all records, documents, books, accounts, and vouchers of the company and any of its subsidiaries, and to require from the directors, officers, and employees of the company and any of its subsidiaries such information and explanations as in his opinion are necessary to enable him to report as required.

3. To appear before and be heard at any meeting of the audit committee and, if he thinks necessary, to require a meeting of that committee.

4. To receive all notices and other communications that a shareholder is entitled to receive relating to any meeting of shareholders.

5. To attend any meeting of shareholders and to be heard on any part of the business of the meeting that concerns him as auditor.

6. To receive from the company written notice of any proposal to appoint another auditor in his place (either before or at the end of his term of office), to make written representations to the company concerning any such proposal, and to have these representations sent at the company's expense to each shareholder entitled to receive notice of the meeting.

LEGAL REQUIREMENTS AS TO FINANCIAL STATEMENTS

Every company, whether or not exempt from the audit requirements, must present financial statements for its latest fiscal year to the annual meeting of shareholders. The statements must be approved by the board of directors, and the balance sheet must be signed by two directors as evidence of that approval. The company is required to send a copy of the statements to each shareholder in advance of the meeting (usually not less than 14 or 21 days before the date of the meeting, depending upon the act). Observance of the time limit is particularly important for companies required to make their financial statements available to the public. Holders of securities other than shares (i.e., bonds, debentures, etc.) are not entitled to receive the financial statements automatically, but are entitled to receive them on demand.

Under most acts, if a company is required to have its financial statements audited, it is an offense to distribute the financial statements to shareholders or others unless the auditors' report is attached.

Form and Content of Financial Statements. The legislation spells out in considerable detail not only what items must be disclosed separately in the financial statements, but also where they must be disclosed. However, because the notes to the financial statements are an integral part of the statements, there is some flexibility in presentation. Thus, as long as the total amount of a particular item is shown in its proper place, any necessary analysis or explanatory details may be given in a note. Such treatment is particularly appropriate for balance sheet items such as inventories, fixed assets, long-term debt, and capital stock.

Two points deserve special emphasis:

1. The law requires "fair presentation." What constitutes fair presentation is a matter of judgment, but it is not automatically achieved by disclosing every individual item specified in the relevant act.

2. Each item referred to in the act must be disclosed separately unless it is not material or unless the act specifically authorizes its omission in special circumstances.

Some acts restrict the use of the term "reserve" in financial statements. This term cannot be used to describe any amount which is in the nature of a direct or contingent liability, or a decline in asset values that has already occurred. Generally speaking, it can be used only to describe an appropriation from retained earnings.

Normally, financial statements should be in comparative form, although this requirement can be waived in certain circumstances. Consolidation is not a legal requirement; the legislation states that a holding company may consolidate the accounts of one or more of its subsidiaries and specifies the very detailed information that must be disclosed concerning subsidiaries not consolidated. This matter, however, is largely of academic interest in view of the CICA requirement that all financial statements be consolidated except in certain rare circumstances.

Publication of Financial Statements. Every public company, no matter where incorporated, must file its annual statements with the provincial securities commission in each province where the company's securities are offered for sale. These statements then

become a matter of public record and are available for inspection by the public. This requirement applies not only to the annual financial statements but also to the half-yearly statements which the company is required to send to its shareholders, and to any quarterly statements the company may send to its shareholders—even though quarterly statements are not legally required.

Certain private companies incorporated under federal legislation are also required to file their financial statements with the federal Department of Consumer and Corporate Affairs in Ottawa, and these statements are available for inspection by the public. The provisions setting out which federal companies must comply with these filing requirements are somewhat complex but, generally speaking, the requirements apply to all public companies and to those private companies whose gross revenues exceed $10,000,000 or whose total assets exceed $5,000,000. To determine whether a company meets this size test, the gross revenues and total assets of all affiliates of the company must be taken into account, regardless of the jurisdiction in which those affiliates are incorporated. A company that meets the size test is exempt from filing only if it is a subsidiary whose accounts are included in the consolidated statements of its parent company, and the parent company itself is incorporated under federal jurisdiction, and is required to file its own statements. Thus, a small Canadian company with no affiliates and not meeting the size test would not be required to file; if, however, that same company were acquired by a foreign corporation, it might meet the size test by virtue of the aggregation provisions and would not be exempt from the filing because its parent company would be neither required nor allowed to file its consolidated statements.

CANADIAN ACCOUNTING PRINCIPLES

Generally accepted accounting principles in Canada, like those in many other countries, fall essentially into two categories: those which are widely followed but are not the subject of any official pronouncements, and those which are contained in official pronouncements. The Canadian body responsible for formulating accounting principles is the Accounting Research Committee of the CICA, and its pronouncements are set out in the CICA Handbook.

The stated principles are in the form of "Recommendations" but have much greater force than this term suggests. Not only are the Recommendations binding upon chartered accountants in their auditing role, but the provincial securities commissions have issued policy statements adopting these Recommendations. Consequently,

any financial statements that do not comply with CICA Recommendations on any material matter have not been prepared in accordance with generally accepted accounting principles.

Although Canadian accounting principles have much in common with those of the United Kingdom and of the United States, differences do exist. Because of the similarity between United States and Canadian format and terminology in financial statements, however, United States users of Canadian financial statements may need to be particularly conscious that words which seem familiar may sometimes bear a different meaning.

A few of the areas in which Canadian accounting principles may differ from those of other countries are mentioned briefly in the following paragraphs.

1. Consolidations. Except in rare circumstances, all subsidiaries must be consolidated. This rule applies even in a "chain" situation where, in a large group of companies, there may be holding companies at different levels in the organization.

2. Non-consolidated Subsidiaries. If non-consolidation of one or more subsidiaries can be justified, the investment must normally be accounted for on the equity basis. Should this also be inappropriate, the investment would be accounted for at cost. The equity method, as defined by the CICA, results in the same net income as would have been reported had the subsidiaries been consolidated. Use of either the equity method or the cost method requires extensive disclosure (above what is required by the companies acts) regarding the financial affairs of the non-consolidated subsidiaries.

3. Effectively Controlled Companies. Companies that are not subsidiaries but over which the investor company has effective control for one reason or another should be accounted for on the equity method, except where this is inappropriate. The Recommendations contain guidelines as to which circumstances might give rise to effective control, but no specific percentage of equity holding is included in these guidelines.

4. Business Combinations. The purchase method should be used to account for all business combinations, except for those rare transactions where an acquirer cannot be identified, in which case the pooling of interests method is permitted. Goodwill arising on an acquisition must be amortized on a straight-line basis over not more than forty years.

5. Income Taxes. The deferred tax allocation method should be used except in rare specified circumstances. This method requires that tax charges or credits deferred to future years are computed at the tax rates in force at the time of deferral; the accumulated balance is not adjusted to reflect any subsequent changes in tax rates. Transfers to income from the balance accumulated in prior periods are computed at the specific rate of accumulation if possible, otherwise at the effective average rate of accumulation. Deferred taxes must not be accounted for on a discounted basis.

The CICA Recommendations on tax allocation have never contained any exemptions relating to intangible development costs in the oil and gas industry, but that industry (to a great extent because of the large degree of control exercised by U.S. corporations) never applied tax allocation methods to such costs. Early in 1974, after considering arguments by representatives of the industry and of the CICA, the securities commissions concluded that this situation should not continue. Accordingly, Canadian companies in the oil and gas industry must now use full tax allocation accounting.

6. Fixed Assets. Although the practice is not widespread, fixed assets may be and sometimes are recorded at appraisal values. Considerable detail concerning the appraisal must be disclosed and the credit arising from the appraisal must be shown as a separate item in the shareholders' equity section of the balance sheet. Charges against income for depreciation must be based on the appraised value of the assets, but an amount equal to that portion of the charge which relates to the appraisal increase may be transferred from the appraisal increase credit to retained earnings.

7. Depreciation. Although not specifically referred to in the CICA Recommendations, the sinking fund method of depreciation has become a generally accepted method for companies in the real estate industry.

8. Extraordinary Items. The treatment of extraordinary items in Canada is similar to that in the United States, but the definition of the term is broader. For example, gains or losses arising from major currency devaluations, or on disposal of a segment of a business, or on the sale or abandonment of property, and losses arising from strikes might in certain circumstances be treated as extraordinary items in Canada.

9. Changes in Accounting Principles. The effect of a change in accounting principles or methods may or may not be applied retroactively, but in no case would the cumulative effect relating to prior years be reflected in the current income statement.

10. Accounts Receivable. Accounts receivable are normally shown as a net figure in the balance sheet without separate disclosure of any allowance for doubtful accounts.

11. Earnings Per Share. For companies with complex capital structures, the figures for earnings per share may differ significantly from those which would be calculated under U.S. rules. The major differences stem from differences in the definition of "common" shares and the treatment of proceeds on deemed exercise of stock options and warrants. The calculations might be identical in the two countries for companies having simple capital structures.

12. Pension Costs. Gains or losses brought about by an actuarial revaluation may either be absorbed in the current period or be spread over the period expected to elapse before the next revaluation. By law an actuarial revaluation is required at least every three years.

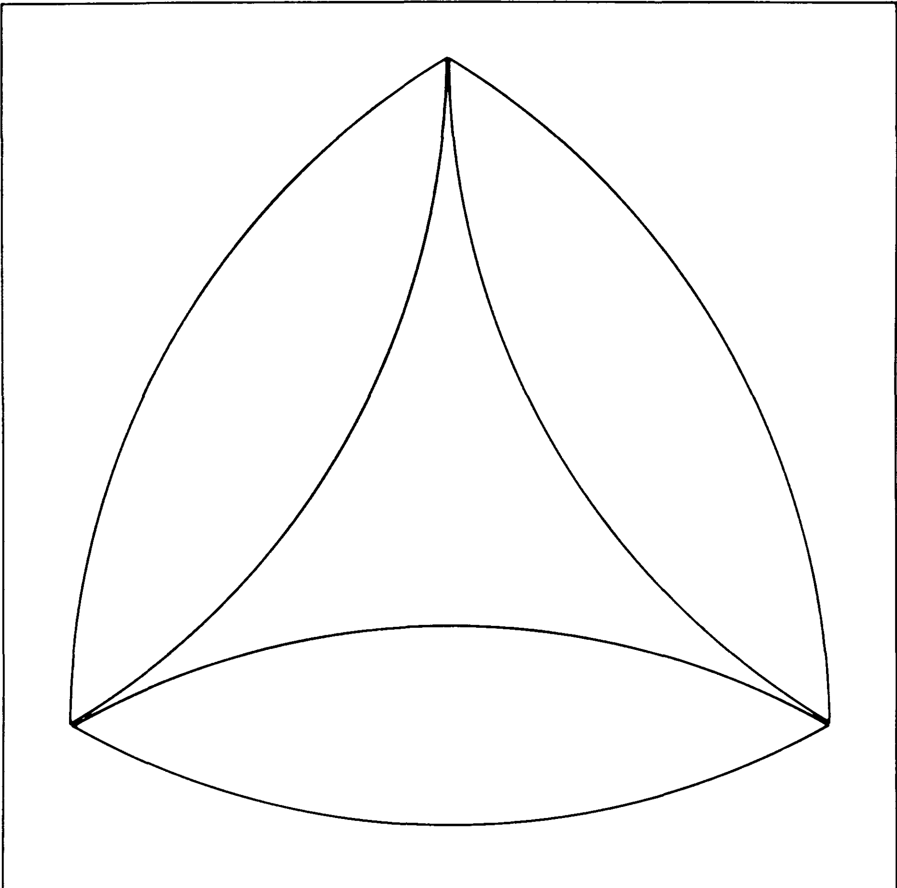
13. Inventory Valuation. Because the LIFO method of valuation is not acceptable for income tax purposes in Canada, it is seldom used for financial reporting even though it is acceptable for that purpose.

CHAPTER VII

Taxation in Canada

Individual Income Tax
Calculation of Individual Income Taxes
Filing, Payment, and Assessment — Individuals
Federal Sales Tax
Federal Excise Tax and Excise Duty
Provincial Sales Tax
Gift and Inheritance Taxes
Other Provincial Taxes
Property Tax

Corporate Income Tax
Residence of Corporations
Deductions from Business Income
Taxable Income
Corporate Tax Rates
Filing, Payment and Assessment — Corporations
Distributions of Corporate Surplus (Dividends)
Capital Gains
Taxation of Nonresidents
Nonresident-Owned Investment Corporation (NRO)



Taxation in Canada

Taxes in Canada are levied by the federal government, provincial governments, and municipalities.

Income Tax. The federal government and all ten provinces levy income tax on the income of both corporations and individuals.

Gift and Inheritance Taxes. Following the introduction of a tax on capital gains, the federal government ceased to levy gift and estate taxes at the end of 1971. Some provinces now levy their own gift and inheritance taxes.

Sales Tax. After income tax, sales tax is the most important source of tax revenue. The federal government levies a sales tax on manufactured goods at the producer or importer level, and all provinces except Alberta have a retail sales tax at the consumer level.

Property Tax. Most municipalities and school boards levy a tax based on the value of real estate in their jurisdictions.

Government Revenue. To illustrate the importance of various sources of taxation, estimated government revenues for the year ended March, 1974 were as follows:

	Federal		Provincial	
	$ Millions	**%**	**$ Millions**	**%**
Income tax:				
Corporations	$ 3,710	15	$ 1,076	7
Individuals	9,226	39	4,303	27
Sales and excise taxes	4,971	21	4,370	27
Succession duty			134	1
Customs duty	1,385	6		
Other taxes (including contributions to pension plan, medicare, and unemployment insurance)	2,381	10	1,993	13
Total taxes	$21,673	91	$11,876	75
Nontax revenue	2,233	9	4,000	25
Gross revenue	$23,906	100 %	$15,876	100 %

Property taxes are estimated to yield in excess of $4 billion to municipalities and school boards.

Taxation in Canada

INCOME TAX — GENERAL

Income tax is levied on both corporations and individuals. After some comments that apply broadly, income taxes will be discussed under four main headings: CORPORATE INCOME TAX, CAPITAL GAINS, TAXATION OF NONRESIDENTS, and INDIVIDUAL INCOME TAX.

Sources of Tax Law. The federal income tax is imposed by the Income Tax Act. The Act underwent major revision in 1971 following reports by a Royal Commission and two parliamentary committees. The principal change was the imposition of a tax on capital gains (formerly untaxed), but a number of other concepts were introduced, including the amortization of purchased goodwill, the taxation of the unrealized capital gains of departing residents, and the taxation of "passive" income earned by foreign affiliates. The major portion of the new Income Tax Act came into force on January 1, 1972. Transitional rules have deferred the application of some provisions.

In addition to the Income Tax Act and regulations made thereunder, tax law is established by courts and tax treaties. The tax authorities also publish official interpretations and rulings for the guidance of taxpayers.

The Income Tax Act is amended at least once a year and the regulations change even more frequently. Budgetary proposals containing tax changes were announced in November, 1974, but had not been enacted when this chapter was written. Nevertheless, these proposals have been incorporated in this chapter in the belief that most of them will be enacted.

All the provinces impose income tax on corporations and individuals under legislation that closely follows the federal Income Tax Act. The provincial legislation in Ontario and Quebec contains minor variations from the federal act.

Tax Treaties. At present, Canada has tax treaties with the following countries:

Australia	Belgium (not yet ratified)
Denmark	Finland
France	Ireland
Jamaica	Japan
Netherlands	New Zealand
Norway	South Africa
Sweden	Trinidad-Tobago
United Kingdom	United States
West Germany	

Tax treaties are designed primarily to prevent double taxation. Thus, they are concerned mainly with the taxation of income derived in one country by a resident of the other country. Matters covered include the provision of rules for allocating income to each country, the rates of nonresident withholding tax, and the grant of foreign tax credits.

In cases of conflict, the provisions of a tax treaty prevail over the Income Tax Act. As part of the tax reform process, the government is revising existing treaties and negotiating new treaties with other countries.

Administration of Tax Laws. The federal Income Tax Act is administered by Revenue Canada – Taxation, which has its head office in Ottawa and district offices in all major cities. For ease of administration, the federal government collects provincial income tax on behalf of most provinces. Quebec, however, collects its own income tax from both corporations and individuals, and Ontario administers its own corporation tax. Alberta recently announced its intention of entering the corporate tax administration field.

Taxable Entities. The following entities are recognized for tax purposes:

1. *Corporation.* Corporations are regarded as separate legal entities, regardless of where they are incorporated.

2. *Individual.* For certain purposes the term includes a trust.

3. *Trust.* A trust is considered a separate taxable entity although, in practice, most income and capital gains may flow through a trust without adverse tax consequences. Mutual fund trusts are subject to special treatment.

4. *Partnership.* The partnership is recognized for the purpose of computing net income, which is allocated to the partners and taxed in their hands. The partnership itself is not a taxable entity. An interest in a partnership is recognized as a capital asset.

Basic Income Tax Terminology. The following definitions of key terms are helpful in understanding Canadian income taxes.

Net Income and Taxable Income. An important distinction is made between the terms net income and taxable income.

Net income consists of gross income less the expenses of earning that income. Net income comprises income from business, property (i.e., investments), employment, and one-half of capital gains less

capital losses realized after 1971. The rules for computing net income are basically the same for corporations and individuals.

Taxable income is net income less certain other deductions. The amount of those deductions is dependent, in some cases, upon the amount of net income. The deductions are not entirely the same for corporations and individuals.

Tax Year. The tax year of a corporation is its fiscal (accounting) period, which may not exceed 53 weeks. The tax year of an individual is always a calendar year. If an individual has business income, it is included in the calendar year in which the fiscal period ends; an individual's fiscal period may not exceed 12 months.

Person. The term *person* is used for both corporations and individuals.

Property and Capital Property. The term *property* is used for all assets of both capital and noncapital nature.

Capital property is used to describe assets whose disposal gives rise to capital gains and losses.

Arm's Length. The concept of arm's length is an ingredient of many rules concerning tax avoidance. Individuals are deemed not to deal at arm's length if they are related by blood or marriage. A corporation is deemed not to deal at arm's length with the person or group of persons controlling it or with another corporation subject to common control. In this context, control means more than 50% ownership of voting shares. Other persons may be considered as not dealing at arm's length, depending upon the facts of each case.

CORPORATE INCOME TAX

Types of Corporations. For income tax purposes, it is necessary to distinguish among the following types of corporations:

Public Corporation is a corporation resident in Canada and whose shares are listed on a Canadian stock exchange. Alternatively, a resident corporation may elect (or be designated by the tax authorities) to be a public corporation if its shares are sufficiently widely distributed. A subsidiary of a public corporation is treated effectively as a public corporation.

Private Corporation is any corporation that is not a public corporation or controlled by a public corporation. Most nonresident corporations and their Canadian subsidiaries are classified as private corporations. The distinction between public and private corporations is important in the taxation of investment income and capital gains (see *Refundable Dividend Tax on Private Corporations,* and *Capital Dividend.)*

Canadian-Controlled Private Corporation is a private corporation either incorporated in Canada, or resident in Canada since June 18, 1971, and not controlled, directly or indirectly, by a public corporation, by nonresidents, or by a combination thereof. Such corporations are taxed at a reduced rate on the first $100,000 of business income under rules set out on page 120.

Canadian Corporation refers to any corporation incorporated in Canada or continuously resident since June 18, 1971. After June 18, 1971, a corporation incorporated outside Canada cannot become a Canadian corporation; this may affect liability to *branch tax* (see *Income of Branches of Foreign Corporations).*

Nonresident-Owned Investment Corporation (NRO) is an investment corporation designed to encourage nonresidents to hold investments in Canada (see *TAXATION OF NONRESIDENTS).*

Personal Corporation and Foreign Business Corporation. After 1971, these categories of corporation no longer exist, and transitional rules apply to such corporations in existence at the end of 1971.

Other Types of Corporations. Several other special types of corporations are recognized for tax purposes, including investment, mutual fund, insurance, and cooperative corporations.

RESIDENCE OF CORPORATIONS

A corporation is resident in Canada if it meets any of the following requirements:

(a) Incorporated in Canada after April 26, 1965.

(b) Incorporated in Canada before April 27, 1965 and, at any time since that date, was resident in Canada or carried on business in Canada.

(c) Central management and control located in Canada.

Taxation in Canada

A resident corporation is taxable in Canada on all its income wherever it arises. A nonresident corporation is taxable in Canada on its income from business carried on in Canada and on capital gains realized on the disposal of certain Canadian assets (see *TAXATION OF NONRESIDENTS*).

NET INCOME

The determination of net income is discussed under the headings of business income, deductions from business income, and other income.

BUSINESS INCOME

The rules for computing business income are basically the same for corporations and individuals. For the most part, business income is calculated on the basis of generally accepted accounting principles. In the following cases, however, the tax treatment of business income may differ from the accounting treatment.

Cash Basis Reporting. Since 1971, only farmers can report on the full cash basis. Professional practitioners are still allowed to report on a modified accrual basis in that work in progress may be excluded from income. Other than for these cases, cash basis reporting is not permitted for tax purposes.

Inventory. Inventory may be valued at the lower of cost and market value, or all at cost, or all at market value. The cost may be based on the actual cost of inventory on hand, the average cost, or the FIFO method; the LIFO method of costing inventory is not permitted. A taxpayer is not specifically required to include overhead in the cost of inventory. The market value of inventory may be determined on the basis of the open market value, net realizable value, or replacement cost, as long as the method adopted is suitable for the type of inventory carried.

A taxpayer is not prohibited from changing his method of valuing inventory provided the change is to another method that is equally acceptable. Permission of the tax authorities is not required for a change, but the effect of any such change must be absorbed in the tax year in which it is made.

Unpaid Accruals. Certain accrued expenses that are deducted from income must be added back to income in a later year if they are not paid within a specified time. The addition to income in a later year may

be avoided if both parties agree to treat the amounts as having been paid and loaned back. These rules apply particularly to:

1. Unpaid salary, wages, or bonus outstanding more than one year.

2. An amount outstanding more than two years and owed to a person with whom the taxpayer does not deal at arm's length.

Government Grants. Depending upon the incentive program under which it is paid, a government grant may (1) reduce deductible expenses, or (2) be deductible from the cost of assets acquired with the grant, or (3) be totally exempt from tax. The following table indicates the tax status of grants paid under some of the more common programs:

Program	Type of Grant	Tax Status
Regional Development Incentives Act (RDIA)	To locate plants in development areas	Cost of assets reduced
Industrial Research and Development	For scientific research and development	Totally exempt from tax
Program for the Advancement of Industrial Technology (PAIT)	For scientific research	Scientific research expenditures reduced
Industrial Research Assistance Program (IRAP)	For scientific research	Scientific research reduced
Industrial Design Assistance Program (IDAP)	To improve industrial design	Deductible expenses reduced
General Adjustment Assistance Program (GAAP)	For consulting assistance	Deductible expenses reduced
Machinery Program	Remission of import duty on machinery	Cost of assets reduced
Equalization of Industrial Opportunity Program (Ontario)	Forgivable loans to locate plants in specified areas	Cost of assets reduced: loan repayments added to cost
Regional Industrial Development Assistance Act (Quebec)	To locate plants in specified areas	Cost of assets reduced

Taxation in Canada

DEDUCTIONS FROM BUSINESS INCOME

To be deductible, an outlay or expense must be incurred for the purpose of gaining or producing income and must be reasonable in the circumstances.

Depreciation. Depreciation deducted for tax purposes (known in Canada as "capital cost allowance") need not be the same as depreciation charged in the financial statements.

Capital cost allowance (CCA) is based on the asset cost, including customs duty, sales tax, and transportation and installation costs. Certain government grants received in connection with the acquisition of the property reduce the cost on which CCA is based. The taxpayer may, at his option, increase asset cost for the interest on loans to acquire them; interest thus capitalized is not deductible from income.

Assets are not depreciated individually. They are grouped in classes subject to specified rates of depreciation and CCA is based on the undepreciated balance in each class. For most classes of assets, CCA must be computed on a declining balance basis; the estimated salvage value of the asset is not taken into account. The common types of assets and their prescribed rates of CCA are as follows:

Asset	Rate
Buildings of wood, brick or stucco on wooden frame, galvanized or corrugated iron	10%
Other buildings	5%
Machinery, equipment, and furniture	20%
Automobiles and trucks	30%
Small tools, dies, jigs, etc.	100%
Aircraft	40%

Leasehold interests and improvements – depreciable in equal amounts over life of lease plus one renewal period – minimum five years, maximum 40 years.

Patents and franchises for fixed term – depreciable in equal amounts over term. Franchises and licenses of unlimited duration are treated in the same way as goodwill (see below).

The above are maximum rates. Less than the full allowance may be

claimed in any year and the undepreciated cost of the asset is reduced only by the amount of CCA actually claimed.

Fast Write-Off for Manufacturing Machinery. As an incentive to the manufacturing and processing industries, manufacturing machinery and equipment acquired after May 8, 1972 may be written off over two years (not more than 50% in the first year). For this purpose, manufacturing and processing specifically exclude the following industries: farming, fishing, logging, construction, utilities, oil and gas, and mining and processing minerals up to the prime metal stage. Manufacturing and processing industries also enjoy a reduced rate of tax (see *Tax Reduction for Manufacturing and Processing Profits).*

Amortization of Goodwill and Other Intangible Assets. One-half the cost of goodwill and certain other intangible assets acquired after 1971 is amortizable at 10% per year on a declining balance basis. If goodwill is sold, one-half the proceeds in excess of the unamortized cost is taxable. For example:

	Cost/ Proceeds	Amortization Account
Cost of goodwill of business acquired in 1973	\$ 60,000 x ½	\$30,000
Amortization 1973 — 10%		3,000
		27,000
Amortization 1974 — 10%		2,700
		24,300
Proceeds of sale of goodwill of same business sold in 1975	\$100,000 x ½	50,000
Amount included in income		\$25,700

The provisions concerning goodwill also apply to franchises and licenses of unlimited duration and to certain other intangible capital expenditures. Special transitional rules apply to the goodwill of a business carried on before 1972: costs incurred before 1972 are not amortizable, and the proceeds of sale of such goodwill, after 1971, are reduced for tax purposes.

Interest. Interest is deductible if incurred to earn taxable income (for this purpose, intercorporate dividends are considered taxable

income). In most cases, interest incurred to acquire shares, to redeem shares, and to pay dividends is deductible.

In 1972, a restriction was introduced on interest paid to nonresident shareholders and their associates who control 25% or more of the shares of a corporation: interest is not deductible to the extent the interest-bearing debt to such nonresidents exceeds roughly three times the paid-up capital and surplus of the corporation.

Cost of Issuing Shares and Bonds. A deduction is allowed for the cost of issuing securities to raise capital, except for commissions paid to underwriters and brokers.

Incorporation and Preincorporation Expenses. Expenses incurred before incorporation and to incorporate are not deductible. In certain cases, they may be amortizable in the same way as goodwill.

Carrying Costs of Land. Interest and property taxes paid on land that is not income producing are not deductible, but may be added to the cost base of the land for capital gains purposes. Where land is held as inventory (for resale or development), a recent budgetary proposal disallows the deduction of interest and property taxes paid after May 6, 1974 and, instead, provides that they be added to the inventory cost of the land.

Recreational Facilities and Club Dues. After 1971, expenditures to provide certain recreational facilities and to pay club dues are not deductible.

Advertising. The cost of advertising is generally deductible. However, advertising in non-Canadian newspapers or periodicals directed primarily at the Canadian market is not deductible and, after 1975, it is proposed to disallow deductions of the cost of advertising on U.S. television and radio stations near the Canadian border.

Reserve for Doubtful Accounts. A reasonable reserve may be deducted for doubtful accounts. The reserve may be based on specific doubtful accounts or on a percentage of all *doubtful* accounts, provided the taxpayer can establish the reasonableness of the percentage on the basis of past experience. A general reserve or one computed as a percentage of *all* accounts receivable is not deductible.

Other Reserves. Reasonable reserves are also permitted for the profit element in installment sales contracts lasting more than two years, for goods or services to be supplied after the year-end, and in

certain other cases. Reserves for warranties and other contingent liabilities are not deductible.

Intercompany Charges. Payments to a nonresident parent or associated corporation are deductible only in amounts that would be reasonable for parties dealing at arm's length.

Scientific Research. After 1973, all expenditures for scientific research may be deducted in the year incurred, or may be carried forward and deducted in subsequent years, at the taxpayer's option. This rule applies to both current and capital expenditures, except for the cost of land which is not deductible.

Exploration and Development. The November, 1974 budgetary proposals distinguish between exploration expenses and development expenses. Canadian exploration expenses, including the cost of drilling exploratory oil and gas wells, are deductible as incurred by corporations whose principal activities are in the oil, gas, or mining industries. Other taxpayers may deduct such expenses incurred after May 6, 1974 at a maximum annual rate of 30% of the diminishing balance.

Canadian development expenses include the cost of acquiring resource properties (including land whose value is based on its mineral resource content), the cost of drilling for oil and gas in known reserves, and the cost of bringing resource properties into production. Such expenses incurred after May 6, 1974 are deductible by all taxpayers at a maximum annual rate of 30% of the diminishing balance.

Foreign exploration and development expenditures are deductible from foreign resource income, within limits, by resident taxpayers.

Depletion. After May 6, 1974, depletion must be "earned" at the rate of $1 for every $3 of eligible expenditure incurred in Canada. Depletion so earned is deductible up to a maximum of 25% of any year's production profits.

Depletion for shareholders ceased to be available after 1971. The three-year tax exemption for new mines ended in 1973.

Provincial Mining Taxes and Royalties. Provincial mining taxes and provincial oil, gas, and mineral royalties payable after May 6, 1974 are no longer deductible for federal income tax purposes. These rules are drafted broadly to cover all provincial taxes and royalties, regardless of how imposed. The effect of these changes is partly offset by a reduction in the rate of tax on the mining and petroleum industries.

Note: The tax matters discussed under the three preceding headings were not law at the time of writing and may be changed before they are finally enacted.

Pension Plan Contributions. An employer may deduct annual contributions of up to $2,500 per employee to a registered pension plan (a plan approved by the tax authorities). In certain circumstances, additional contributions for past service are also deductible.

Political Contributions. Contributions made to political parties are not deductible from income but limited tax credits are available for small contributions (see page 144).

Dividends Paid. Dividends paid by corporations are not deductible from income.

Taxes, Interest, and Penalties. Income tax—and interest and penalties thereon—paid to the federal or provincial governments are not deductible. Foreign taxes on income are not normally deductible but may be creditable against Canadian income tax (see *Foreign Tax Credits).* Generally, all other taxes connected with the earning of income, including sales tax, property tax, and provincial capital tax, are deductible. These taxes are discussed later in this chapter.

OTHER INCOME

Capital Gains. One-half of net capital gains (gains less losses) realized after 1971 must be included in income (see *CAPITAL GAINS).*

Interest Received. Regardless of the method used to account for other income, a corporation may adopt either the cash or accrual basis of accounting for interest received, provided the method adopted is used consistently. Effective 1975, financial institutions (banks, trust companies, life insurance companies, etc.) must use the accrual basis.

Dividends Received. With certain exceptions, all dividends received are included in net income. However, dividends from Canadian corporations that are included in net income are deductible in computing taxable income. Dividends from nonresident corporations that are not affiliated are taxable, but the taxpayer is normally entitled to a tax credit for any foreign tax withheld on such dividends.

Private corporations (see page 109) are subject to a special "refundable dividend tax" on most dividends not included in taxable income – (see page 121).

Income from Foreign Affiliates. Foreign affiliates are defined as nonresident corporations in which a Canadian resident has a 10% or greater interest in any class of shares. For Canadian tax purposes, the income of foreign affiliates consists of active business income or passive income known as "foreign accrual property income" (FAPI).

Dividends received from foreign affiliates are generally exempt from tax in Canada. However, a dividend received after 1975 from an affiliate carrying on an active business in a non-treaty country is taxable after specific deductions for foreign taxes attributable to the dividend.

Beginning with an affiliate's 1976 fiscal period, a Canadian shareholder must pay tax on his share of the passive income of a *controlled* (more than 50%) foreign affiliate when that income is earned and not when distributed. No further tax is payable when the income is received in Canada.

Passive income comprises income from a non-active business, investment income, and certain service income considered to have been diverted from Canada. It does not include inter-affiliate dividends and an affiliate's income from interest, rent, royalties, etc. paid to it by another foreign affiliate and which are deductible by that affiliate from its income from an active business.

Rental Income. Income from rentals is taxable after deducting expenses, including capital cost allowance (depreciation). After 1971, capital cost allowance on rental real estate has been restricted to prevent the creation of rental losses as a "shelter" for non-rental income. The restriction on capital cost allowance does not apply to (1) corporations whose principal business is leasing, developing, or selling real estate and (2) new residential rental projects commenced after November 18, 1974 and before 1976.

TAXABLE INCOME

Having determined net income by deducting from gross income the expenses of earning that income, net income is further reduced by certain other deductions to arrive at *taxable* income. The deductions to calculate taxable income are made in the following order:

Charitable Donations. Corporations may deduct gifts to registered charitable organizations of up to 20% of net income. Excess donations may be carried forward for one year.

Dividends Received. Dividends from Canadian corporations included in net income are deductible in computing taxable income. A deduction may also be made for certain dividends received from foreign affiliates (see *Income from Foreign Affiliates).*

Loss Carryovers. Before 1972, only operating losses could be carried over to other years. After 1971, any non-capital loss may be carried back one year and forward five years. The right of carryover is lost if there is a change in control of the corporation *and* the business in which the loss was sustained is discontinued.

Capital Losses. Capital losses may only be offset against capital gains. Net capital losses (one-half the excess of capital losses over capital gains) may be carried back one year and forward indefinitely. The right of carryover is lost if there is a change in control of the corporation.

Where a loss is carried back to the preceding year, an amended tax return must be filed for that year.

There is no provision in the tax laws permitting the loss of one corporation in an affiliated group to be offset against the income of another corporation in the group. Consolidated tax returns are not permitted.

CORPORATE TAX RATES

A corporation resident in Canada pays income tax both to the federal government and to any province in which it carries on business through a permanent establishment. A permanent establishment means a fixed place of business and includes an agent established in a province who has general authority to contract on behalf of his principal or who has a stock of goods owned by his principal from which he regularly fills orders.

The income tax payable to a province is largely offset by a credit against the federal tax.

Basic Federal Tax Rates. Since 1971, the basic rates of federal tax have been, and projected future rates are, as follows:

1972	46.5%	(50% less 7% special reduction)
1973	49%	
1974	48%	
1975	47%	
1976 and thereafter	46%	

These rates are for calendar years. A composite rate must be computed for a corporation whose fiscal period does not end on December 31, based on the number of days in the fiscal period falling in each calendar year. Thus, the basic federal tax rate for a corporation with a 12-month fiscal period ending on March 31, 1975 will be computed as follows:

275/365 of 48%	36.16
90/365 of 47%	11.59
Basic federal tax rate	47.75%

Abatement for Provincial Taxes. A deduction may be made from federal tax equivalent to 10% of taxable income earned in any province (but not in the Yukon and Northwest Territories, which do not impose an income tax).

Mining and Petroleum Industries. Substantial changes were recently made in the taxation of mining and petroleum profits earned after May 6, 1974. After the abatement for provincial taxes, the effective rate of federal tax will be 25% of mining profits and 30% of petroleum profits (declining to 28% for 1975 and 25% thereafter). The rate reductions will partly offset the nondeductibility of provincial mining taxes and royalties and the more restricted deductions for exploration and development expenses and depletion (these items were noted previously). The changes concerning the mining and petroleum industries had not been enacted into law at the time of writing and in this area, as in other complex areas, professional advice and assistance will be necessary.

Foreign Tax Credits. A credit is available against federal income tax and, in some cases, provincial tax for foreign taxes paid on foreign-source income. The foreign taxes available for credit are income or profits taxes paid to a foreign country or political subdivision of that country.

A foreign tax is either "business-income tax" (a tax paid on income from a business carried on in the foreign country) or "non-business-

income tax." Credits for business-income tax and non-business-income tax must be calculated separately and on a country-by-country basis.

The credit is limited to the lesser of (1) the foreign tax actually paid and (2) the proportion of federal tax attributable to the foreign-source income. For the business-income tax credit, federal tax is calculated *before* deducting the 10% abatement for provincial tax; for the non-business-income tax credit, federal tax is calculated *after* deducting the 10% abatement (most provinces allow a credit for foreign tax paid on investment income). Unused credits for foreign business-income tax may be carried forward five years; there is no carryover of credits for non-business income tax.

Canadian-Controlled Private Corporations. A special "small business" tax rate is available to Canadian-controlled private corporations. The small business rate is achieved by allowing a tax credit against the basic federal tax payable, which reduces the federal tax on the first $100,000 of "active business income" to 25% (before the abatement for provincial tax). The small business rate continues to be available each year until the corporation has accumulated $500,000 of before-tax income from an active business. The payment of dividends out of active business income reduces the accumulation of that income at the rate of $4 for every $3 of dividends paid. If a corporation's active business income consistently exceeds the annual limit, eligibility for the small business rate will be lost eventually, even if all after-tax income is distributed as dividends. For associated corporations, the limits of $100,000 and $500,000 apply to the entire group.

The small business rate replaced the reduced tax rate that was available to all corporations on the first $35,000 of income before 1972. The small business rate does not affect the calculation of provincial tax and is not available to foreign-controlled corporations or to public corporations and their subsidiaries.

Control Acquired by Nonresidents. To prevent nonresidents from benefiting from the small business rate, the tax reductions previously allowed are recaptured if the corporation ceases to be Canadian-controlled. If, at the time control is acquired by nonresidents, the corporation has retained earnings that include income originally taxed at the small business rate, a tax is levied on the corporation to raise the overall tax on that income to the regular rates. A public corporation may be liable for this tax on becoming foreign-controlled if it had been a Canadian-controlled private corporation at some previous time.

The tax may be avoided if, before control is acquired by nonresidents, dividends of the requisite amount are paid. Professional advice on this matter is especially necessary.

Tax Reduction for Manufacturing and Processing Profits. A further reduction is available for Canadian manufacturing and processing profits earned after 1972. The reduction lowers the effective rate of federal tax on such profits to 40%, or 20% where the small business rate is also available (before the abatement for provincial tax). The industries excluded from the definition of manufacturing and processing for this purpose are the same ones excluded for the fast write-off of depreciable assets (see page 113).

If an eligible corporation also has non-manufacturing activities (which include for this purpose selling and administrative activities), not all profits are necessarily eligible for the tax reduction. Eligible profits are determined by a formula based on the cost of labor and fixed capital employed directly in manufacturing and processing activities. A simplified formula is available to corporations whose income from an active business does not exceed $100,000. As noted, the tax reduction is not available for manufacturing activities carried on outside of Canada.

Refundable Dividend Tax on Private Corporations. To prevent private corporations from being used to defer tax on dividend income, a special refundable tax is levied on all private corporations, whether Canadian-controlled or not, equal to one-third the aggregate of:

1. Portfolio dividends received.

2. Dividends from controlled subsidiaries to the extent that the dividend resulted in a dividend tax refund (see below) to the paying corporation.

3. Dividends from foreign affiliates deducted in computing taxable income (see page 117).

Dividend Tax Refund. The one-third tax on dividends, together with approximately half the regular tax on other investment income (interest, rental income, and taxable capital gains), is refundable to the corporation at the rate of $1 for every $3 of dividends paid. Thus, investment income, other than dividends, flowing through a private corporation is taxed at an effective rate of approximately 25%, while dividends flow through a corporation taxfree.

Special 10% Surtax. A 10% surtax has been imposed on federal corporate tax payable on income earned between May 1, 1974 and April 30, 1975. If a corporation's fiscal year ends on other than April 30, 1975, the surtax is imposed on a pro rata basis. This surtax does not apply to manufacturing or processing profits, to mining and petroleum profits, to investment income of private corporations, or to Canadian-controlled private corporations claiming the small business tax rate.

Provincial Taxes on Corporations. To simplify tax administration, the federal government collects provincial tax on behalf of all provinces except Quebec and Ontario, which collect their own corporate tax. The calculation of taxable income for federal and provincial purposes is the same, except for minor variations in Quebec and Ontario.

Allocation of Income to Provinces. A corporation that has a permanent establishment in more than one province must allocate its taxable income among all provinces in which it carries on business through a permanent establishment. The allocation is normally made using a formula based on the gross revenue and wages attributable to each province.

Provincial Income Tax Rates. The provincial tax rates for 1975 had not been announced at the time of writing. The following rates were in effect during 1974:

Newfoundland	13%
Nova Scotia	10%
Prince Edward Island	10%
New Brunswick	10%
Quebec	12%
Ontario	12%
Manitoba	13%
Saskatchewan	12%
Alberta	11%
British Columbia	12%

Ontario allows a special tax credit to Canadian-controlled private corporations eligible for the federal small business tax rate. The credit is equal to 5% of the annual increase in capital employed in Ontario but cannot exceed $3,000.

Summary of Tax Rates. For ease of reference, the following table summarizes the combined federal and provincial income tax rates that

apply to the business income of corporations in the provinces of Ontario, Quebec, and British Columbia—where the provincial rate is currently 12%:

	General Rate		Small Business Rate	
	Manufacturing and Processing Profits	Other Operating Income	Manufacturing and Processing Profits	Other Operating Income
1973	42%	51%	22%	27%
1974	42%	50%	22%	27%
1975	42%	49%	22%	27%
after 1975	42%	48%	22%	27%

Notes:

1. The small business rate is only available to Canadian-controlled private corporations on the first $ 100,000 of business income.

2. Tax rates for years after 1974 are only projected rates, and professional advisers must be consulted for the latest available rates.

3. The rates for 1974 and 1975 must be further adjusted for the 10% surtax on income earned between May 1, 1974 and April 30, 1975.

4. The above rates do not apply to corporations in the oil, gas, and mining industries (see 119).

Sample Income Tax Calculation for 1975

A private corporation carrying on business in Ontario, not entitled to the small business tax rate, has the following income for the year ended December 31, 1975.

Manufacturing and processing income	$100,000
Other business income	10,000
Investment income:	
Interest on bonds and taxable capital gains	10,000
Portfolio dividends	30,000
Net income	150,000
Less: portfolio dividend income	30,000
Taxable income	$120,000

The income tax calculation is as follows (including the 10% surtax on income earned between January and April, 1975):

	Manufacturing Income	Other Business Income	Interest and Taxable Capital Gains	Total
Federal Tax:				
Basic tax at 47%	$47,000	$4,700	$4,700	$56,400
Less: provincial abatement (10% of taxable income)	(10,000)	(1,000)	(1,000)	(12,000)
Reduction for manufacturing income (7% of $100,000)	(7,000)	—	—	(7,000)
	30,000	3,700	3,700	37,400
Surtax: 10% of $3,700 x 4/12	—	123	—	123
	30,000	3,823	3,700	37,523
Ontario Provincial Tax: 12% of taxable income	12,000	1,200	1,200	14,400
Combined tax	42,000	5,023	4,900	51,923
Effective rate	42%	50.23%	49%	
Add: Federal tax on portfolio dividends (1/3 of $30,000)				10,000
Total income tax payable				$61,923

Of the $61,923 taxes payable, $12,500 is refundable for the tax on:	
Portfolio dividends (1/3 of $30,000)	$10,000
Interest and taxable capital gains (25% of $10,000)	2,500
Total	$12,500

The $12,500 would be refunded to the corporation if and when it pays dividends of $37,500 ($1 refund for every $3 of dividends paid).

FILING, PAYMENT AND ASSESSMENT — CORPORATIONS

Filing. Every corporation must file a federal tax return on a form T2 within six months of the end of its fiscal period. The return includes a calculation of the tax liabilities for the year due to the federal government and to all provinces except Quebec and Ontario.

Consolidated tax returns are not permitted. A corporation must also file a provincial return within the same time limit if it has a permanent establishment in Quebec (form C-17) or Ontario (form CT23) or British Columbia (form CT-1); the British Columbia return covers capital tax only (see page 153).

Various information returns are also due on different dates for such matters as salaries and wages, dividend and interest payments, and payments to nonresidents.

Penalties may be imposed for late returns: the lesser of 5% of tax unpaid or $500 for late returns of income, and $10 per day, subject to various limits, for late information returns. Extensions of time for filing are not granted.

Payment of Tax. A corporation is required to pay advance installments of its estimated federal and provincial tax liabilities. Federal installments are due on the last day of each month during the fiscal period and are based on the lesser of the estimated tax payable on the corporation's current year's income and the actual tax payable on the preceding year's income.

Although the annual tax return is due six months after the year end, any balance of tax payable is due within two or three months of the fiscal year end, depending on the type of corporation.

The timing of tax payments to Quebec is similar to the above. At present, Ontario requires installments every second month, with the first installment due by the 15th day of the third month in the fiscal period.

The federal government currently charges 6% interest for late payments, and Ontario and Quebec impose higher rates. Such interest payments are not deductible.

Assessment. A formal notice of assessment is issued shortly after the filing of a tax return, indicating whether the return has been accepted as filed or has been revised by the tax authorities. Any tax overpayment is normally refunded when the notice of assessment is issued. A taxpayer has 90 days from the mailing date of the assessment to object to any revisions. If he is unable to agree with the tax authorities, he may appeal to the Tax Review Board or to the Federal Court of Canada.

A taxpayer's books and records are subject to audit by Revenue Canada and assessments may be revised by Revenue Canada within

the four years following the issue of the original notice of assessment. The four-year time limit does not apply where it has been waived by the taxpayer or in cases of fraud or misrepresentation.

DISTRIBUTIONS OF CORPORATE SURPLUS (DIVIDENDS)

The tax treatment of corporate distributions is extremely complex, and the following summary relates only to the principal types of dividends paid by Canadian corporations.

Taxable Dividends. This term describes all dividends except those specifically exempted from tax. The treatment of taxable dividends in the hands of the shareholder depends on the status of the shareholder, as follows:

Public corporation: Excluded from taxable income.

Private corporation: Excluded from taxable income but may be subject to special 1/3 refundable dividend tax (see page 121).

Individuals: 4/3 of dividends received included in taxable income, and tax credit available approximately equivalent to the "gross-up." For example:

Dividend received	$300
1/3 gross-up	100
Included in taxable income	$400
Tax credit available	$100

Nonresidents: Dividends are subject to withholding tax (see page 131).

Capital Dividend. A private corporation may pay out as a capital dividend the tax-free half of capital gains realized after 1971 (see *CAPITAL GAINS*). A capital dividend is not taxable in the hands of the shareholder nor is the cost base of his shares reduced for capital gains purposes. This device ensures that only half of a capital gain flowing through a private corporation is taxable to the shareholder. The payment of capital dividends may be restricted if the corporation also

has 1971 surplus on hand (see below). Public corporations may not pay capital dividends. Nonresident shareholders are subject to withholding tax on capital dividends.

1971 Surplus Distributions. For tax purposes, surplus earned before 1972 is considered to comprise, approximately:

1. After-tax income, less dividends paid, for the period 1950 – 1971.

2. Pre-1972 capital gains (not taxed before 1972) and pre-1950 retained earnings.

Distributions may be made from the above categories of surplus after the payment of a special 15% tax on 1. above, provided the required formalities are completed. Such distributions are treated as a return of capital to the shareholder. They are not taxable in his hands but do reduce the cost base of his shares. Nonresident shareholders are not subject to withholding tax on distributions of pre-1972 surplus.

Dividends out of Designated Surplus. If a resident corporation receives a dividend out of the preacquisition earnings of a subsidiary, it is subject to a special 25% tax on the dividend; and the amount of the dividend, less tax, reduces the cost base of the shares. The 25% tax does not apply to tax-free distributions out of 1971 surplus (see above).

If a dividend out of designated surplus is paid to a nonresident corporation, a special 15% tax is levied on the paying corporation, in addition to nonresident withholding tax payable on the dividend (see page 131).

CAPITAL GAINS

Capital gains were not taxed before 1972, and transitional rules ensure that only gains and losses accruing after 1971 are taken into account. One-half of capital gains realized after 1971 is taxable. One-half of capital losses may, generally, be offset against the taxable half of capital gains realized in the same year or may be carried over to other years. Subject to a limited exception for individuals, a capital loss may not be offset against other income. There is no distinction in Canada between short- and long-term capital gains. The basic rules for calculating capital gains and losses are the same for corporations and individuals.

Capital Property. "Capital property" is the term used to describe assets whose disposal gives rise to capital gains and losses. There is no

definition of capital property in the tax legislation, and the traditional distinctions between capital and income prevail. This is an area where professional advice should be obtained, especially where real estate transactions are involved.

Securities, land, and depreciable assets are the types of property that most commonly give rise to capital gains. Goodwill and franchises and licenses of unlimited duration are not capital property (for their tax treatment, see *Amortization of Goodwill and Other Intangible Assets).* Windfalls and lottery prizes are not treated as capital gains (or income), and gains on certain other property, including a taxpayer's principal residence, are exempt.

Personal Property. For capital gains purposes, property held as an investment or used to earn income is distinguished from property held for the personal use and enjoyment of the owner and his family ("personal-use property"). Because of the different treatment of losses, there are two categories of personal-use property. In the first category, which includes a summer cottage, automobile, or boat, gains are taxable but losses are never deductible. In the second category, known as "listed personal property" (which comprises works of art, jewelry, rare books, stamps, and coins), gains are taxable and losses are deductible only from gains in the same category (losses may be carried back one year and forward five).

For simplicity, gains (and losses where appropriate) are only recognized on personal-use property to the extent that either the cost or the proceeds exceed $ 1,000. Thus, a $900 painting sold for $ 1,200 will have a deemed cost of $ 1,000, and the capital gain will be $200.

When Capital Gains Arise. A capital gain or loss generally arises on a change in the beneficial ownership of an asset such as results from a sale or gift. A gain or loss may also arise in cases that normally might not be considered as a change in ownership. These cases include:

1. The death of the owner.
2. A change in the use of an asset (for example, when a house that has been rented is reoccupied by the owner).
3. When the owner ceases to reside in Canada (see page 139).
4. Insurance proceeds from a fire involving capital property.
5. Every 21 years in the case of property owned by a trust.

Calculation of Capital Gains. A capital gain or loss is basically the difference between the cost of an asset and its sales proceeds less expenses. In the case of assets owned before 1972, special rules apply for determining their cost for capital gains purposes (see *Transitional Capital Gains Rules).*

When calculating a gain or loss on an asset that has not been realized (on the occurence of one of the events noted above), the owner is deemed to receive proceeds equal to the market value of the asset. Proceeds equal to market value are also imputed on a gift of assets and on a transfer at less than market value between parties not dealing at arm's length (see page 108).

Deferment of Capital Gains. A number of special provisions, most of which are extremely complex, enable the tax consequences of certain transactions to be deferred. Some of the provisions, known as "rollovers," are elective, others are automatic. To obtain a "rollover," the transaction must fall exactly within the enabling provision, and a person contemplating such a transaction should obtain professional tax advice. Where a rollover occurs, the cost base of the original asset or of the original owner carries over to the eventual disposition. A rollover may be available in the following cases:

1. The transfer of property to a Canadian corporation in exchange for shares.

2. The statutory amalgamation of two corporations (at present, only possible for entities incorporated in the same jurisdiction).

3. The winding-up of a wholly-owned Canadian subsidiary and the transfer of all its assets to its Canadian parent company.

4. The reorganization of the capital structure of a corporation.

5. The transfer of property by a partner to a Canadian partnership.

6. The transfer of property to a spouse or to a trust for a spouse.

7. The conversion of a convertible bond, debenture, or share.

8. Where property is expropriated, destroyed, or lost and replaced by other property.

9. A recent proposal would make a rollover available on a share-for-share exchange in a takeover bid.

The taxation of a capital gain may also be deferred where the proceeds are payable by installments.

Transitional Capital Gains Rules. The transitional rules apply only to assets acquired before 1972. When such assets are disposed

of, the capital gain is the lesser of (1) the actual gain and (2) the increase in value since 1971. Similarly, the capital loss is the lesser of (1) the actual loss and (2) the decline in value since 1971. To calculate the increase or decrease in value since 1971, it is necessary to know the market value of the asset on "Valuation Day," which was December 22, 1971 for Canadian publicly-traded shares and December 31, 1971 for other property.

If the sales price is between the original cost and market value on Valuation Day, there is no gain or loss for tax purposes, but any expenses of sale (e.g., commissions, advertising, legal fees) are treated as a capital loss.

A number of special rules exist for computing the cost of certain property owned before 1972, including bonds, shares acquired as a result of specific transactions, partnership interests, and assets acquired in non-arm's-length transfers.

Option for Individuals. Individuals have the option of computing all capital gains and losses on property owned at the end of 1971 on the basis of Valuation Day values. This method is advantageous when Valuation Day values for all assets exceed their original cost. The option must be selected when filing the tax return that includes the first disposal of an asset owned on Valuation Day. The option, once taken, is irrevocable.

Capital Losses. Capital losses realized during a tax year (other than losses on personal-use property) are offset against gains realized in the same year.

The deductibility of capital losses is restricted in certain cases. For example, no deduction is allowed for a loss incurred by a corporation on the transfer of property to its controlling shareholder or to a sister corporation. Generally, where an asset is sold and similar property is acquired in the 30 days preceding or following the sale, the loss is not deductible but may be added to the cost of the acquired asset.

Capital Loss Carryovers. If capital losses (other than losses on personal-use property) exceed capital gains in any year, one-half of the excess constitutes a "net capital loss" that may be carried back one year and forward indefinitely. A net capital loss may only be offset against the taxable portion of capital gains in the carryover years.

The rules for individuals are the same as for corporations except that individuals may deduct from other income up to $ 1,000 per year on an unused net capital loss.

TAXATION OF NONRESIDENTS

Canada taxes nonresidents by two methods: a flat rate withholding tax is applied to most types of investment income and certain other periodic income, and normal income tax rates are applied to business and employment income and certain capital gains from Canadian sources. However, the tax rules outlined in this section may be substantially modified by provisions of the applicable tax treaties (see page 106).

Withholding Tax on Nonresidents. Withholding tax is deductible from certain amounts *paid or credited* to nonresidents by a resident of Canada. The withholding tax is generally 15% and is to be increased to 25% in 1976 but, as has been noted, may be modified by applicable tax treaties. The tax is withheld on the gross payment or credit, before any expenses are deducted. Tax at the current 15% rate must be withheld in the following cases, subject to the exceptions noted:

1. Management or administration fees, except:
   a) Fees for services rendered to unrelated parties by the nonresident in the normal course of his business.
   b) Fees in the nature of reimbursement for specific expenses incurred by the nonresident.
2. Interest, except:
   a) Interest paid by an NRO (see page 135).
   b) Interest on certain government bonds and government guaranteed securities.
   c) Certain limited types of interest payable in non-Canadian currency.
   d) Interest payable to a nonresident to whom a "certificate of exemption" has been issued (because he is exempt from tax in his own country).
3. Guarantee and commitment fees payable after November 18, 1974.
4. Estate or trust income.
5. Rents, royalties, and payments for "know-how," except:
   a) Copyright royalties.
   b) Payments for use of tangible property outside Canada.
6. Alimony.

7. Certain retirement allowances, pension benefits, and annuities. In practice, most pensions and annuities are exempt from withholding tax under Canada's international tax treaties.

8. Dividends, except certain dividends paid out of 1971 surplus (see page 127). The usual 15% withholding on dividends is reduced to 10% (20% after 1975) if the paying corporation is 25% or more Canadian-owned.

9. Payments for use of films and video tapes. The withholding tax is 10% until the end of 1975, at which time it increases to 25%.

Option for Recipients of Rental Income and Timber Royalties. A nonresident may elect to file a tax return as if he were a Canadian resident for rental income from real estate and timber royalties. The tax is calculated on net income, which allows all expenses, including depreciation, to be deducted. If this option is exercised, tax previously withheld is offset against the income tax payable, and any excess is refunded. The nonresident may use this option in any year it is advantageous, provided that once used, it must be used in any year that real estate is sold for an amount in excess of its depreciated value for tax purposes.

Option for Recipients of Pension Benefits or Alimony. Nonresidents who receive certain types of pension and retirement benefits or alimony also have the option of filing tax returns and claiming exemptions as if they were residents. This option is beneficial where the tax liability is less than the tax withheld; the difference is refunded to the nonresident.

Nonresident's Income Taxable in Canada. Nonresidents are taxable, subject to treaty provisions, on certain Canadian-source income. They must file a Canadian tax return and pay tax at the same rates as Canadian residents in any year they have income of the following types:

Income from Business. Nonresidents are taxed on the income of a business carried on in Canada. Tax treaties, where applicable, generally determine what constitutes carrying on business. The usual key test is the existence of a permanent establishment. If the nonresident is from a country with whom Canada does not have a tax treaty, a wider definition of carrying on business applies. The wider definition does not require the existence of a permanent establishment and includes the soliciting of orders or the offering of goods for sale in Canada through an agent or servant.

Income from Employment. A nonresident is taxable on employment income from those duties performed in Canada. Income from duties performed outside Canada for a Canadian employer is not taxable.

The above does not apply to a former Canadian resident. An individual who ceases to reside in Canada but continues to receive employment income from a Canadian resident is taxable in Canada on that income, except to the extent:

1. It is subject to tax in another country, or

2. It is paid for business-connected duties performed abroad for his employer or a person related to his employer.

Deductions from Income. Generally, the nonresident can deduct expenses reasonably related to the income earned. Personal exemptions (see page 142) are also available but must be apportioned on a time basis as follows:

1. Business income — proportion of year business is carried on in Canada.

2. Employment income — proportion of year employee actually is in Canada.

Capital Gains. Nonresidents are taxable on capital gains realized on the disposal of "taxable Canadian property," which includes:

1. Real estate in Canada.

2. Assets of a business carried on in Canada.

3. Shares in Canadian private corporations.

4. Property on which a former resident of Canada elected to defer the accrued gains when he last ceased to be resident in Canada (see page 139).

Gains on shares in public corporations are not normally taxable. However, where the shareholder, since 1971, either alone or with related persons, has owned 25% or more of the shares of any class, at any time in the five years preceding the sale, any gain realized on the sale of the shares is taxable in Canada.

Compliance. To ensure compliance, any nonresident intending to sell or give taxable Canadian property (other than shares in a public corporation and property described in item 4 above) must file a notice with the tax authorities and either pay or give security for tax of 25% of the accrued gain. Failure to comply may result in the purchaser or donee being liable for tax equal to 15% of the purchase price or market

value. This compliance procedure does not apply to a transfer by inheritance.

A nonresident is required to file a Canadian tax return in any year in which he disposes of taxable Canadian property, whether or not he filed the notice mentioned in the preceding paragraph.

Income of Branches of Foreign Corporations. An unincorporated Canadian branch of a foreign corporation is taxed at the regular corporate rates on its Canadian-source business income. Because an unincorporated branch does not pay dividends, a "branch tax" is imposed to replace the withholding tax that would otherwise be payable on income distributed to nonresidents. From a tax point of view, the disadvantage of an unincorporated branch as against a Canadian subsidiary is that branch tax is levied when the income is earned whereas nonresident withholding tax is payable only when and if dividends are paid.

Branch tax of 15% (25% after 1975) is imposed on the branch's taxable income after deducting:

1. Federal and provincial income taxes payable for the year.

2. Capital gains for the year on the sale of nonbusiness assets. Capital gains on the sale of business assets are not deductible and are subject to branch tax.

and after adding:

3. Dividends from Canadian corporations received by the branch.

Any portion of the after-tax income invested in land and depreciable assets in Canada is not subject to branch tax that year. In the year such assets are sold and not replaced, the deferred branch tax is payable.

An exemption from branch tax is granted to banking enterprises and to corporations engaged in transportation, communications, and mining iron ore.

If a foreign corporation were to become a resident in Canada (for example, by moving its head office to Canada), it would still be liable to branch tax. In this situation, the tax could be avoided by incorporating in Canada.

NONRESIDENT-OWNED INVESTMENT CORPORATION (NRO)

The NRO is an unusual and effective vehicle for nonresidents wishing to invest in Canada. Income and capital gains can be accumulated in an NRO at relatively low tax rates and reinvested without being repatriated to the foreign country where they would be taxed in the hands of the NRO's shareholders. An NRO is a regular corporation that is accorded NRO status for tax purposes.

NRO's are not subject to provincial income tax except in Quebec where they receive favorable treatment. Special rules, not discussed here, affect NRO's incorporated before 1972. To qualify as an NRO, the corporation must meet the following requirements:

1. All shares must be owned by nonresidents.
2. All bonds, debentures, and funded indebtedness must be owned by nonresidents.
3. All income must be derived from owning or trading securities, lending money, rents, royalties, interest, dividends, etc.
4. Rental income may not exceed 10% of gross revenue.
5. The *principal* business must not be the making of loans or dealing in securities as a trader rather than as an investor.
6. The corporation must elect to be treated as an NRO within 90 days of the commencement of its first tax year.

No deduction is allowed for interest paid by an NRO, but a nonresident lender is not liable to withholding tax on such interest. Foreign taxes are deductible from income but are not creditable against Canadian tax. Tax is payable at 25% on the full amount of capital gains realized on taxable Canadian property, equal to 50% on one-half the gain that would normally be taxable to a nonresident.

The effective rates of tax (including withholding tax where appropriate) on different types of an NRO's income, and either retained or paid out as dividends, are shown on the following page.

	Retained		Distributed	
	Before 1976	After 1975	Before 1976	After 1975
Dividends—foreign and Canadian	15%	25%	15%	25%*
Interest, rents, and royalties	15%	25%	15%	25%*
Capital gains:				
– Foreign securities	nil	nil	15%	25%*
– Shares in Canadian private corporations and 25% or greater holdings in Canadian public corporations	25%	25%	25%	25%
– Other shares in Canadian public corporations	nil	nil	nil	nil
– Canadian bonds, debentures, and mortgages	nil	nil	nil	nil
– Real estate in Canada	25%	25%	25%	25%
– Real estate outside Canada	nil	nil	15%	25%*

* Effective rate may be reduced to 15% by treaty.

INDIVIDUAL INCOME TAX

An individual resident in Canada is taxable on his world income, whether or not it is remitted to Canada. Foreign tax credits are available for foreign-source income. For the taxation of nonresident individuals, see *TAXATION OF NONRESIDENTS*.

Residency Requirements. The residence of individuals is basically a question of fact. An individual is considered resident in Canada for the entire tax year if he meets any one of the following requirements:

1. Is ordinarily resident in Canada.
2. Is intermittently in Canada for 183 days or more in the year.
3. Is a government employee working abroad.

Residency under (1) above is affected by such factors as whether the taxpayer has his usual or settled home in Canada, whether he makes substantial and habitual visits to Canada, whether his family is in Canada, whether he owns or rents a home in Canada, the reason for

and duration of his stay in Canada, and his previous residence in Canada.

Part-Year Residents. The 183-day rule does not apply to an individual coming to Canada with the intention of becoming a Canadian resident or to a person who leaves Canada after a period of residence. In either case, such a person is only taxable for the part of the tax year he is actually in Canada, provided he is not employed nor carries on business in Canada during the part of the year he is not resident. For a part-year resident, his taxable income is his world income for the period he is resident in Canada, plus his Canadian-source income (capital gains and, perhaps, rental income) for the balance of the year determined as for a nonresident (see page 131). Personal exemptions are deductible in proportion to the period of residence in Canada.

INCOME OF INDIVIDUALS

An individual is always on a calendar year basis for tax purposes.

Business Income. The rules for calculating business income are the same for individuals as for corporations (see page 110). An individual, whether sole proprietor or partner, is taxable on his business income in the calendar year during which the accounting period of his business ends (see page 108).

Income From Employment. Employment income includes wages, salary, bonus, commission, director's fees, gratuities, pensions, and any other remuneration received from an office or employment. Within two months of the end of the year, every employee must receive a statement (federal form T4, Quebec form TP4) from each employer showing income (including taxable benefits), tax withheld, and other deductions made by the employer. After 1974, the first $1,000 of non-government pension income is exempt from tax.

Taxable and Nontaxable Fringe Benefits. Some fringe benefits are taxable and others, traditionally, are not. Taxable benefits include:

1. Allowance for personal or living expenses, except certain travel allowances.

2. Free or subsidized board, lodging, or housing.

3. Personal use of automobile provided by employer. A minimum taxable benefit is computed, based on the availability rather than actual use of the car. The minimum amount taxable is usually 12% per

year of the automobile's original cost, or 1/3 the rental payments in the case of a leased car; the actual taxable benefit based on personal use may be much higher.

4. Stock option plans. The taxable benefit arises in the year an option is exercised. The benefit is the difference between the option price and the market value of the shares on the date the option is exercised.

Nontaxable fringe benefits include:

1. Interest-free and low-interest loans.

2. Recreational facilities or social and athletic club dues (payments may not be deductible to the employer; see page 114).

3. Moving expenses paid by employer.

4. Uniforms and protective clothing provided by employer.

Investment Income. Dividends, interest, and rental income are taxable to the individual.

Dividends. Taxable dividends received from Canadian corporations are "grossed-up" by 1/3 so that the amount included in income is 4/3 of the dividend received, and a corresponding credit is given against the tax payable for the 1/3 gross-up (see page 144). Dividends received from foreign sources are included in income after adding back any foreign withholding tax, which tax may be available as a credit against Canadian tax.

Interest. A taxpayer may account for interest on a cash or accrual basis, provided the same method is used consistently. Interest is considered received when it is credited to the taxpayer's account. There is no exemption for government bond interest.

$ 1,000 Interest and Dividend Exemption. In 1974, the first $ 1,000 of Canadian-source interest income is exempt from tax. The exemption applies to net interest income; that is interest received less tax-deductible interest paid. For 1975, grossed-up dividends from Canadian corporations are included with net interest eligible for the $ 1,000 exemption.

Rental Income. Income from real estate is taxable after deducting expenses and capital cost allowance, if claimed. Since 1971, capital cost allowance on rental real estate has been restricted to prevent rental losses being used to shelter nonrental income. This restriction

has been lifted for new residential rental projects commenced after November 18, 1974 and before 1976.

Capital Gains. One-half of capital gains less losses realized after 1971 are included in income. The general rules for calculating capital gains and losses are covered in the section *CAPITAL GAINS.*

Departing Resident. The so-called "departure tax" provisions are designed to tax certain accrued but unrealized capital gains of a person ceasing to be resident in Canada. A departing resident is deemed to have disposed of certain property at its market value immediately before departure. The property commonly affected is:

- real estate outside Canada.
- shares in Canadian public corporations representing less than a 25% interest.
- shares in non-Canadian corporations.
- bonds, debentures, notes, etc.

The first $5,000 of deemed gains are exempt, and the taxpayer may also elect to defer some or all of the deemed gains until the property is actually sold. If he so elects, the taxpayer must provide security equivalent to 25% of the accrued gains even though such gains, when realized, may not be taxable in Canada by virtue of a tax treaty. The nonresident taxpayer must file a Canadian tax return for any year in which he disposes of such property; and, if no tax is payable, the security will be returned. Any foreign tax paid on the gain may be credited against Canadian tax payable.

Short-Term Residents. A concession is granted to an individual residing in Canada for fewer than 60 months in the ten years preceding his departure. For such person, departure tax is not levied on property acquired before he last became resident or to property acquired by inheritance since he became resident.

New Residents. If a person became a resident after 1971 and owns property that would be subject to departure tax if he ceased to be resident, for capital gains purposes the cost base of that property is equal to its market value at the time he became a resident.

None of the departure tax provisions affect "taxable Canadian property," gains on the disposition of which are taxable in Canada (subject to treaty) when realized by any nonresident, whether or not he formerly resided in Canada (see page 133).

Income Averaging. The tax burden on capital gains and certain other exceptional items of income may be spread into the future by a form of income averaging introduced in 1972. A resident individual may purchase an "income averaging annuity contract" for an amount equivalent to the income eligible for averaging, less one year's annuity income. The tax effect of this is: (1) the exceptional income item is included in income; (2) the cost of the annuity is deductible in the year of purchase; and (3) the annuity payments are taxable when received.

DEDUCTIONS FOR INDIVIDUALS

The following types of deductions from gross income are available to individuals.

Employment Expenses. A general employment expense deduction is allowed equivalent to the lesser of $150 and 3% of employment income, other than director's fees. This deduction does not have to be substantiated. A special deduction for expenses is available to commission salesmen.

Pension Plan. An employee's contributions to a registered pension plan are deductible up to a maximum of $2,500 per year for current service. Special rules apply to the deduction of contributions for service in prior years.

Registered Retirement Savings Plans. An individual may contribute, each year, up to $4,000 or 20% of eligible income, whichever is less, to a registered retirement savings plan (RRSP), and the contributions are deductible from income. Eligible income comprises income from business or employment. If the taxpayer is also a member of a registered pension plan to which his employer contributes, his combined contributions for current service to both pension plan and RRSP are restricted to the lesser of $2,500 or 20% of eligible income.

Miscellaneous Deductions from Income. Other deductions are available from income. The following are the common items:

1. Contributions to the Canada or Quebec Pension Plans.
2. Federal unemployment insurance premiums.
3. Professional fees and union dues.

4. Most moving expenses not reimbursed by the employer.

5. Child care expenses of a working mother and, in some cases, a father. The deduction is subject to several limitations.

6. Alimony and child maintenance payments, but the recipient is taxable.

7. Tuition fees, but these are deductible by students, not parents.

8. Costs incurred in holding investments such as interest, safekeeping charges, and fees paid for investment advice.

9. An annual deduction of up to $ 1,000 to a Registered Home Ownership Savings Plan. This deduction is available only to those not already owning a home and is subject to a lifetime maximum of $ 10,000. Withdrawals from the Plan will not be taxed provided they are applied towards the purchase of a home, including furniture and appliances.

Mortgage Interest and Property Taxes. Mortgage interest and property taxes are *not* deductible from income when paid on a private residence.

DEDUCTIONS FROM NET INCOME

From the net income of individuals, the following deductions are available in calculating taxable income.

Charitable Donations. Donations to registered Canadian charities and certain other organizations are deductible up to a maximum of 20% of net income before this deduction. Excess donations may be carried forward one year. Individuals are required to file receipts with their tax returns to substantiate this deduction.

Medical Expenses. Medical and dental expenses incurred in any 12-month period ending in the tax year are deductible to the extent they exceed 3% of net income, provided they were not claimed in the previous year and cannot be reimbursed under a government or private insurance plan.

Standard Deduction. As an alternative to deductions for charitable donations and medical expenses, a taxpayer may claim a single standard deduction of $ 100.

Student Deduction. A deduction is available to a student or (to the extent that the student cannot claim it) to a person supporting him of

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Standard Deduction. As an alternative to deductions for charitable donations and medical expenses, a taxpayer may claim a single standard deduction of $ 100.

Student Deduction. A deduction is available to a student or (to the extent that the student cannot claim it) to a person supporting him of

$50 for each month the student is at a university or similar institution. This is in addition to the deduction for tuition fees that is available only to students.

Loss Carryovers. The general rules for loss carryovers are the same for individuals as for corporations (see page 118). The only difference is that an individual may deduct from other income up to $1,000 per year of an unused net capital loss (one-half the excess of capital losses over capital gains).

Personal Exemptions. Starting in 1974, personal exemptions are increased automatically each year to reflect increases in the cost-of-living index, and similar increases are made in the tax rate brackets for individuals.

The most common exemptions for 1975 are as follows (the amounts reflect a 10.1% increase over 1974):

Basic exemption	$1,878
Additional exemption for a married person supporting a spouse (reduced by excess of spouse's income over $334)	1,644
The following additional exemptions are available:	
Individual over 65	1,174
Blind or invalid individual or spouse (per person)	1,174
Dependent children under 16	352
Dependent children 16 and over	646

CALCULATION OF INDIVIDUAL INCOME TAXES

Federal Income Tax Rates. The basic scale of federal tax rates for 1975 incorporates a 10.1% cost of living adjustment over 1974. The rates for 1975 are as follows:

Taxable Income	Federal Tax			
$ 587 or less		9%		
587	$ 53 plus	18%	on next	$ 587
1,174	158	19%		1,174
2,348	382	20%		1,174
3,522	616	21%		2,348
5,870	1,109	23%		2,348
8,218	1,649	25%		2,348
10,566	2,236	27%		2,348
12,914	2,870	31%		3,522
16,436	3,962	35%		11,740
28,176	8,071	39%		17,610
45,786	14,939	43%		24,654
70,440	25,540	47%	on excess	

Provincial Income Tax Rates. Income tax for provinces other than Quebec is computed as *a percentage of federal tax,* after deducting the dividend tax credit. At the time of writing, only Newfoundland had announced a change in tax rates for 1975. The 1974 tax rates are as follows:

	Percentage of Federal Tax
Newfoundland	38% (40% in 1975)
Nova Scotia	38.5%
Prince Edward Island	36%
New Brunswick	41.5%
Ontario	30.5%
Manitoba	42.5%
Saskatchewan	40%
Alberta	36%
British Columbia	30.5%

The variation in rates arises, in part, from the different methods used to finance health insurance.

Quebec tax rates are applied to taxable income and not to federal tax payable. The rates for Quebec are on a graduated scale, similar to the federal rates. For 1974 they are as follows:

Taxable Income	Tax				
$ 2,000 or less			10%		
2,000	$ 200	plus	11%	on next	$ 1,000
3,000	310		12%		2,000
5,000	550		14%		2,000
7,000	830		16%		2,000
9,000	1,150		18%		2,000
11,000	1,510		20%		3,000
14,000	2,110		22%		10,000
24,000	4,310		24%		15,000
39,000	7,910		26%		21,000
60,000	13,370		28%	on excess	

Federal Tax Adjustments. To arrive at federal tax payable, the tax computed at the basic rates is subject to the adjustments discussed in the following paragraphs.

Dividend Tax Credit. The federal tax payable is reduced by 20% of grossed-up taxable dividends received from Canadian corporations. This credit represents 4/5 of the amount added by the gross-up; the remaining 1/5 is reflected in reduced provincial tax (other than Quebec), which is calculated as a percentage of federal tax *after* deducting the dividend tax credit.

Special Tax Reduction. For 1975, federal tax is reduced by 8% of the tax payable, with a minimum of $200 and a maximum of $750.

Foreign Tax Credits. Resident individuals are allowed a credit for taxes paid to other countries on foreign income. The rules for computing foreign tax credits are the same as for corporations (see page 119). After 1975, the foreign tax credit allowed individuals on investment income (other than rental income on property situated outside Canada) will be limited to 15% of such income; foreign tax in excess will be allowed as a deduction from income.

Political Contributions. Since August 1,1974, a tax credit is available for contributions made to federal political parties. The tax credit is 75% of the first $100 and increases to a maximum tax credit of $500 for contributions of $1,150 or more. The credit is also available to corporations.

Abatement for Quebec Taxpayers. Because of different arrangements for financing government programs, tax rates in Quebec

are higher than in other provinces. As a result, individuals resident in Quebec or with business income earned in Quebec are allowed a reduction of 24% of their federal tax liability for income attributable to Quebec.

Income not Earned in a Province. If a taxpayer has income on which he does not pay provincial tax (for instance, because he resides in the Yukon or Northwest Territories or has foreign business income), his federal tax liability is increased by 30% in lieu of provincial tax.

General Averaging. If an individual's taxable income exceeds both 110% of his previous year's income and 120% of the average income of the four preceding years, an averaging formula is automatically applied by the tax authorities. The formula is applied only to reduce taxes but the saving is rarely significant.

Provincial Tax Adjustments. As previously mentioned, tax payable to all provinces except Quebec is computed as a percentage of federal income tax after deducting the dividend tax credit.

Allocation of Income to Provinces. Provincial income tax is payable to the province in which the taxpayer resides on December 31. If the taxpayer carries on business in a province in which he does not reside, he is required to allocate part of his income to that province using a formula based on gross revenue and wages attributable to the province.

Tax Payable to Quebec. The rules for computing taxable income in Quebec are basically the same as the federal rules but with the following variations:

1. Quebec has no exemption for children under 16, but higher family allowances are paid that are not taxed.

2. Quebec has lower personal exemptions and has not followed the federal government in linking personal exemptions and tax rates to the cost of living.

Quebec tax is based on the rates previously noted, and the Quebec dividend tax credit is 11.25% of the grossed-up amount of dividends received.

Provincial Tax Credits. Residents of Ontario, Manitoba, and Alberta are allowed a credit against provincial income tax mainly in respect of property taxes paid. This relief primarily benefits lower-income groups.

Sample Personal Income Tax Calculation for 1975

An individual, resident in Ontario, has taxable income of $25,000, which includes $4,000 of taxable dividends from Canadian corporations ($3,000 received, grossed up to $4,000).

Federal Tax

$16,436 (at various rates)	$3,962
8,564 (at 35%)	2,997
$25,000	6,959
Less: dividend tax credit – 20% of $4,000	800
Basic federal tax	$6,159
Less: special tax reduction – 8% of $6,159	493
	5,666

Provincial Tax

Ontario – 30.5% of basic federal tax of $6,159	1,878
Total income tax payable	$7,544

FILING, PAYMENT, AND ASSESSMENT – INDIVIDUALS

Filing. The tax year of an individual is the calendar year. Tax returns must be filed by April 30 of the following year, and extensions for filing are not granted. The return requires a calculation of the taxpayer's tax liability for the year. The federal return (form T1) also covers tax payable to all provinces except Quebec.

Taxpayers resident in Quebec or with business income earned in Quebec are also required to file a Quebec tax return (form TP1) by April 30.

Every individual taxpayer is required to have a social insurance number, which is used, among other purposes, as a reference number by the tax authorities.

Joint returns are not permitted. The incomes of married persons are taxed separately.

Payment. Federal and provincial income tax on employment income is withheld at the source. Therefore, most individuals are not required to pay advance installments. A balance of tax due is payable by April 30, and any tax overpaid is usually refunded automatically.

Installments (Advance Payments). Installments of estimated taxes are required where more than one-quarter of a taxpayer's income is not subject to withholding and his tax liability exceeds $400. Installments are due in four equal amounts on March 31, June 30, September 30, and December 31 in the tax year, and are based on the lesser of the estimated tax payable for the year and the actual tax paid for the preceding year.

Interest and Penalties. Interest is charged for late payment of tax: 6% by the federal government, 8% in Quebec. The penalty for late filing is 5% of the unpaid tax (maximum $500). Interest and penalties are not deductible, but interest on refunds is taxable.

Assessments. The rules for assessments and appeals by individuals are the same as for corporations (see page 124).

SALES TAXES

FEDERAL SALES TAX

Subject to the exceptions noted below (see *Exempt Goods*), federal sales tax is levied on all goods manufactured in Canada or imported into Canada. A decision on whether to establish a business in Canada must take into account the impact of federal sales tax on the proposed operation. Decisions that might be influenced by sales tax considerations include:

1. Whether to import goods or produce them in Canada.
2. Whether to sell directly to consumers or through distributors, wholesalers, or retailers.
3. Whether to locate a plant close to the source of raw materials or close to the customers.
4. Whether to use a bonded warehouse for imported goods.

Source of Law and Administration. Federal sales tax is imposed by Part V of the Excise Tax Act, which is administered by the Customs and Excise division of Revenue Canada. Many of the rules for the administration of the tax are contained in memoranda published by the tax authorities, and rulings are given in specific cases. There is some flexibility in the administration of the law to prevent taxpayers obtaining competitive advantages or suffering disadvantages.

Rate of Tax. On goods manufactured or produced in Canada, the sales tax is payable by the *final manufacturer* at the rate of 12% of his

selling price. The tax is payable when the goods are delivered to the purchaser, or when the purchaser acquires title, whichever is earlier. On installment sales, the tax is payable as the installments become due.

On imports into Canada, sales tax is at the rate of 12% of the dutiable value of the goods plus any import duty. The tax is payable by the importer when the goods are imported or when they are taken out of a bonded warehouse, whichever is later.

Building Materials. On certain building materials, the rate of sales tax is 5% instead of 12%.

Licensed Wholesalers. Under certain conditions, wholesalers may assume responsibility for sales tax by becoming "licensed wholesalers." In this case, sales tax is payable by the licensed wholesaler when he sells the goods and not by the manufacturer when he sells the goods to the wholesaler. The tax is still 12% of the manufacturer's selling price (the wholesaler's cost) or 12% of the duty-paid value in the case of imported goods. The advantage of being a licensed wholesaler is that the payment of the tax is deferred from when he buys the goods to when he sells them.

Who is a Manufacturer? The legislation does not define the terms "manufacturer" or "producer," and their common meaning applies. However, by law, certain activities are deemed to be, or not to be, manufacturing. Problems may arise in determining whether a person is a manufacturer if he is engaged in the cutting, diluting, or repacking of goods, in construction, or in repairing and rebuilding goods.

A person who does not physically manufacture goods may, nevertheless, be deemed to be a manufacturer by virtue of patent or other proprietary rights to goods being manufactured by others on his behalf.

Certain small manufacturers who sell directly to consumers are exempt from federal sales tax.

Classification as a manufacturer may be advantageous or disadvantageous depending on whether the goods produced are taxable or tax-exempt. To ensure that sales tax is levied only on the final manufacturer, goods purchased by manufacturers are mostly exempt. Therefore, if a manufacturer produces exempt goods such as exports, foodstuffs, pharmaceuticals (see *Exempt Goods*), classification as a manufacturer is advantageous because most purchases will be exempt. If taxable goods are produced, classification as a

manufacturer is disadvantageous because sales tax is levied when the goods are sold.

Taxable Selling Price. For goods produced in Canada, the taxable selling price is normally the manufacturer's selling price. However, to ensure that sales tax is levied on a uniform basis for *all* manufacturers, the actual selling price may require adjustment to obtain the amount on which tax is paid. The invoice price will be increased by an appropriate amount if the customer is billed separately for excise duty, packing or containers. Likewise, the invoice price will be reduced for cash discounts or volume rebates allowed to customers and for transportation, installation, and erection costs included in the selling price, provided these items are charged separately on the invoice.

Where a manufacturer sells directly to retailers or consumers, the actual selling price may be higher than would be charged to wholesalers. In such cases, special rules exist for calculating the equivalent wholesale selling price.

Goods Produced for Own Use or Rental. Where a manufacturer produces goods for his own use or rental, rules exist to establish a notional taxable selling price, and tax is payable when the goods are used or rented.

Intercompany Transactions. The tax authorities have the power to establish the taxable selling price where goods are sold to associated companies other than at fair value.

Exempt Goods. Goods may be exempt from sales tax for any of the following reasons:

1. The goods themselves are exempt.
2. The end-use of the goods renders them exempt.
3. The status of the purchaser renders the goods exempt.

Totally exempt goods include all exports, foodstuffs, pharmaceuticals, footwear, heavy construction equipment, certain transportation equipment, clothing, electricity, natural gas, fuels for heating, and packaging material for exempt goods.

Most goods purchased by manufacturers for use in their manufacturing operations are exempt. Such goods include raw materials and partly manufactured goods, certain processing materials, and production machinery and equipment.

All goods purchased for their own use by provincial governments and public hospitals are exempt. Certain categories of goods are also exempt when sold to schools and municipalities; to farmers; fishermen; and to operators of mines, quarries, and shipping, and logging concerns.

How to Obtain Exemptions. To obtain an exemption based on the use of the goods or on the status of the user, the purchaser must furnish the seller with a certificate stating the grounds on which the exemption is claimed. The certificate is usually imprinted upon the purchase order. If a certificate of exemption proves invalid, sales tax is normally assessed on the seller.

Refunds of Sales Tax. When previously taxed goods are sold as new for a use qualifying for exemption, the seller may claim a refund within two years. In some instances, an exemption is not allowed at the time of sale but only when the goods are actually used; in such cases refunds are claimed by the user.

Administration of Sales Tax. All manufacturers of taxable goods must be licensed; manufacturers who produce only tax-exempt goods need not be licensed, but they enjoy the same exemptions as other manufacturers. In addition, as noted previously, wholesalers may elect to be licensed.

Sales tax returns and payments of tax must be made on a monthly basis. All licensed manufacturers and wholesalers are subject to audit, generally every two years. There is no statutory time limit for the assessment of additional sales tax, but a new audit generally does not go back beyond the previous audit.

FEDERAL EXCISE TAX AND EXCISE DUTY

Certain goods are subject to excise tax, excise duty, or both, in addition to sales tax. These additional taxes are similar to sales tax in that they are levied on the manufacturer or importer.

Excise duty is levied on beer, liquor, and tobacco products. The duty is calculated on a unit basis and is included in the taxable selling price used to calculate excise tax and sales tax.

Excise tax is levied on jewelry, clocks, and watches at 10% of the taxable selling price and at various rates on tobacco products and wines. The tax is not included in the taxable selling price subject to sales tax. Excise tax is also levied in the following cases:

1. A 10% tax is imposed on insurance premiums paid to insurers not licensed in Canada, whether the premiums are paid directly or through an intercompany charge.

2. A special graduated tax was recently imposed on large cars, private aircraft, and high-powered motorcycles and boats.

3. Air fares have been taxed at a maximum of $5 per fare since December 1, 1974.

4. Since the international oil crisis, exported crude oil has been subject to a special excise tax.

PROVINCIAL SALES TAX

Every province except Alberta imposes sales tax on retail sales of tangible personal (movable) property in the province and on property brought in for use in the province. In some provinces, tax is also imposed on some services, notably telephone service. Goods purchased for resale and raw materials for incorporation into finished products are exempt when purchased. Production machinery is exempt in some provinces and taxable in others. Foodstuffs are generally exempt.

The tax is paid by the consumer, with the retailer being responsible for collection and payment. On goods brought into the province, the purchaser is responsible for the tax.

The rates of tax and exemptions vary from province to province. Current tax rates range from 5% to 8% of the selling price (including any federal sales tax incorporated therein). In addition to sales tax, provinces levy a variety of other taxes based on consumption, including tobacco tax, motor fuel tax, meals and hotel room tax.

MISCELLANEOUS TAXES

GIFT AND INHERITANCE TAXES

The federal government abandoned the estate tax and gift tax field in 1972 following the introduction of the tax on capital gains. For a time, all provinces except Alberta had gift and inheritance tax legislation, but several provinces subsequently abandoned these taxes.

Inheritance Tax. Duties on inheritance vary considerably from province to province, but the following rules may be considered typical.

Duty is payable by the successor or beneficiary on property passing on the death of an individual, where the property is:

1. Situated in the province (the common law rules on "situs" apply), or

2. Situated outside the province and the beneficiary is resident in the province or the deceased was domiciled in the province.

Property passing on death usually includes certain gifts made before death and the proceeds of life insurance policies.

Exemptions for estates vary from $10,000 to $100,000. Exemptions for property passing to a surviving spouse vary from $150,000 to complete exemption; other exemptions are available to special classes of beneficiaries. Exempt property is included in the value of the estate for the purposes of computing the overall rate of duty.

Rates vary considerably: marginal rates of tax rise to 70%, but the overall rate of tax never exceeds 50% of the value of the estate. Depending upon the province, rates are governed by one or more of the following factors:

- the aggregate value of the estate
- the relationship of the beneficiary to the deceased
- the amount of the bequest

Tax credits are usually available for inheritance taxes paid on property situated outside the province.

Depending upon the jurisdiction, returns are required from beneficiaries and executors within three or six months of death.

Gift Tax. Gift tax is levied on individual donors (not corporations) by the province in which the donor resides, regardless of where the property is situated, where the gift is made, and to whom it is made. It is also levied on donors outside the province for gifts of real estate situated in the province.

The term gift is broadly defined and includes a number of transactions not normally considered gifts (such as the non-arm's-length sale of property at less than market value). Exemptions are available for:

1. Testamentary and charitable gifts.

2. Gifts up to $2,000 per year per donee plus $5,000 to spouse, with an overall maximum of $15,000 per year.

3. Certain once-in-a-lifetime gifts of farm or residential property.

4. In Ontario, all gifts to a spouse.

The tax rates are the same for all provinces. Taxes start at 15% on taxable gifts up to $25,000 and rise to 50% for gifts over $200,000.

Returns are required from donors by April 30 of the following year.

OTHER PROVINCIAL TAXES

Capital and Place of Business Tax. In addition to income tax, three provinces levy an annual capital tax on corporations. Taxable capital comprises share capital, retained earnings, reserves, and certain debt of the corporation; a deduction is allowed for a proportion of any investments in other corporations. The rates of tax are as follows:

Quebec	1/5 of 1%)	
Ontario	1/5 of 1%)	of taxable capital
British Columbia	1/10 of 1%)	

If a corporation has permanent establishments in more than one province, a formula is used to allocate capital to each province. Quebec also levies a small tax for each place of business in the province.

Both capital and place of business taxes are deductible for income tax purposes. In Ontario and Quebec, these taxes are reported on the income tax return (see page 124). In British Columbia, a special return is due within six months of the corporation's year-end.

Taxes and Royalties on Logging, Mining, and Petroleum Industries. Quebec and British Columbia levy special logging taxes, which are largely creditable against federal and provincial income tax.

Most provinces levy special taxes, royalties or other charges based on production, on corporations in the mining and petroleum industries. These charges were formerly deductible in computing income for federal and provincial income tax purposes. However, recent proposals noted elsewhere will substantially change the federal tax treatment of the mining and petroleum industries. Professional advice is necessary in this area.

Land Speculation Tax (Ontario). Ontario recently introduced a tax on profits from speculative land transactions. The rate of tax was originally 50% but was reduced to 20% when the federal government refused to treat the tax as deductible for income tax purposes. The tax applies to transactions after April 9, 1974; for land owned on April 9, 1974, the profit calculation is based on the market value of the land at that date. The taxable profit is also reduced by the cost of improvements, carrying costs, and a special allowance for farmers.

The tax is directed mainly at speculative transactions in undeveloped land and residential properties. Property not subject to the tax includes the following:

1. Industrial or commercial property where the buildings are worth at least 40% of the whole.

2. Residential rental property where the building is worth at least 40% of the whole and the property is held for ten years. A partial exemption is available where the property is held for from three to ten years.

3. Property that the owner has built upon or improved, subject to certain minimum requirements.

4. A person's principal residence and summer cottage.

Certain share transactions may be taxable if land comprises more than one-half the underlying assets of the corporation.

The transferor is responsible for the tax, which is due when the transaction takes place. Unless a certificate is obtained showing that no tax is payable, a special lien attaches to the land for unpaid tax.

The Ontario government has extensive powers to issue regulations under and to grant exemptions from the Land Speculation Tax Act.

Land Transfer Tax (Ontario). Ontario, like other provinces, levies a tax on all transfers of land. The rates are generally less than 1%, but Ontario imposes a special rate of 20% on land conveyed to nonresidents after April 9, 1974. This tax is discussed more fully in Chapter 2.

PROPERTY TAX

Property tax is the major source of tax revenue available to municipalities and is levied on real estate within their boundaries. No municipality levies income or sales taxes.

Property tax is based on the taxable assessed value, which is usually less than the current market value of the property. The rates and assessing practices vary widely, with the rate of tax on business or commercial property usually higher than on residential property. Generally, municipalities set property tax rates and collect the revenues. In some cases, property tax is also levied by the provincial government and by independent school boards.

Some provinces offer income tax credits, grants, or subsidies in respect to property tax, primarily for families in the lower income brackets.

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