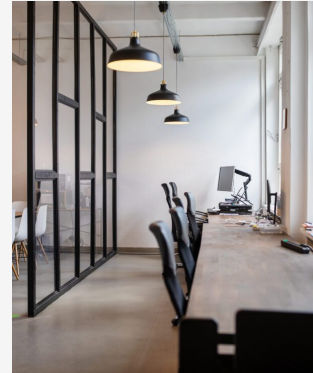


Should founders incorporate their startups in Canada or the United States?

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We're often asked by Canadian entrepreneurs, "Should I incorporate my startup company in Canada or in Delaware (or another U.S. state)? My U.S.-based investors and advisors are telling me that I need to have a Delaware company."

We're also often asked by founders who already incorporated their startup in Canada, "Should I relocate or flip my Canadian company into Delaware?"

The answers to these questions are not always straightforward, and when advising Canadian founders to use U.S.-domiciled companies, U.S.-based investors and advisors don't always have a complete understanding of the material benefits of having a Canadian startup company.

This article outlines the primary reasons why Canadian founders may want to use a Canadian or U.S. company for their business.

Reasons to incorporate in Canada

Many of the reasons for Canadian founders to use a Canadian entity are tax-related. Specifically, Canadian companies that qualify as a "Canadian-controlled private corporation" (CCPC) under the Canadian *Income Tax Act* (the Act) — which is generally the case for Canadian startup companies — and their Canadian shareholders are eligible to receive certain benefits and preferential tax treatment. These material benefits are not available to Canadian taxpayer founders of startups with a U.S.-domiciled parent company.

SRED credits

CCPCs can be eligible for a refundable scientific research and experimental development (SR&ED) investment tax credit rate of 35% on qualified expenditures, up to a limit of \$3 million per year. This translates into these companies receiving the equivalent of approximately \$1–\$1.5 million per year of non-dilutive funding. For startups building out their minimum viable product, or even later-stage companies scaling and refining their business, the enhanced refundable SR&ED credit can be very valuable.

Lifetime capital gains exemption

Canadian founders and other Canadian shareholders of a CCPC may be able to use their lifetime capital gains exemption upon the sale of their shares. In other words, shareholders of a CCPC whose shares qualify as small business corporation shares, which is generally the case for Canadian startup companies, can exempt part of the proceeds from the sale of their shares from capital gains tax. The lifetime capital gains exemption is currently \$1.25 million for dispositions that occur on or after June 25, 2024; the exemption is expected to increase further in subsequent years and indexation for inflation will resume in 2026.

Employee tax treatment

Canadian employees of CCPCs are entitled to significantly better tax treatment with respect to stock options than Canadian employees of non-CCPCs. [This article](#) provides more details on these benefits, which can be an important factor in recruiting and retaining a team based on Canada.

Access to federal and provincial grants as non-dilutive capital

There are also many federal and provincial grants and tax credits available to Canadian companies and CCPCs. Consult your Osler team to learn more.

Founder tax planning

There are other strategies available to Canadian founders and shareholders of Canadian companies that can reduce Canadians' tax liabilities by millions of dollars relative to using U.S.-domiciled companies. These include the use of family trusts, "intellectual property drop down" transactions and other strategies. Consult your Osler team to learn more.

Reasons to incorporate in the U.S.

The most commonly cited reasons why Canadian founders should incorporate U.S. companies include the following.

QSBS status for investors and U.S. founders

Most U.S.-domiciled startup companies are eligible to issue shares with Qualified Small Business Stock (QSBS) status to their U.S. taxpayer investors and stockholders. Specifically, U.S. taxpayers holding QSBS may be able to exclude the greater of \$10 million or 10 times the stockholder's adjusted tax basis in the QSBS from their taxable amount upon the sale of QSBS. Note that this benefit is only available to U.S. taxpayers, so for Canadian taxpayers, these U.S. tax benefits come at the expense of Canadian taxpayers who would otherwise be entitled to the benefits of having a Canadian company described above.

In addition, for various reasons, QSBS status is generally more highly valued by very early-stage U.S. investors, such as angel investors and pre-seed funds, than by later-stage U.S. investors.

Access to capital

Some investors and advisors believe that incorporating a U.S. company, even if you are a Canadian founder, will provide better access to capital, on the grounds that U.S. investors will be more familiar with investing in U.S. companies than in Canadian companies (and will value QSBS status per the above). While this may be true in some cases, our data and deal experience show that most top-tier U.S. venture capital firms and other startup investors are very comfortable investing in Canadian companies. Successful Canadian startups such as

Shopify, 1Password, Wealthsimple, Cohere and others, all of whom raised large amounts of capital from U.S.-based investors, demonstrate this in practice. See our [*Deal Points Report*](#) for more statistics and insights into venture capital and growth equity financing transactions in Canada's emerging and high growth companies ecosystem.

Regulated business

Some businesses operating in highly regulated areas, such as defense or life sciences, may require a U.S. entity in order to comply with regulatory requirements. In these cases, a U.S.-domiciled parent company may be necessary, or there could be ways to operate the business with a Canadian parent company that has a U.S.-domiciled subsidiary or affiliate entity. Consult your Osler team to learn more.

Conclusion

The choice of domicile is an important decision that can have long-term impacts on a startup company and the economic outcomes of its founders and shareholders. Every founder's and startup's situation is different, so the answer of where to domicile won't always be the same, but for Canadian founders (and their investors and advisors), it is important to have a full understanding of the Canadian-specific benefits that Canadian taxpayers will lose by incorporating in the U.S.