Canada's tax system

Things to know

Canada's tax system is largely governed by the federal *Income Tax Act* and its regulations, as well by the sales tax, corporate tax and other laws of the provinces and territories. Residents of Canada are subject to tax on their worldwide income, while non-residents of Canada are generally subject to tax only on their income from Canadian sources.

A non-resident who, in a particular taxation year, was employed in Canada or carried on a business in Canada, is liable to pay income tax on the non-resident's taxable income earned in Canada. Also, the disposition of "taxable Canadian property" may result in a non-resident being subject to tax in Canada. Provincial taxes are also payable by a non-resident on taxable income earned in a province where the non -resident carries on business through a permanent establishment located in that province.

A corporation will generally be resident in Canada if its "central management and control" is located in Canada (e.g., if the corporation's board of directors meets in Canada). In addition, generally a corporation that was incorporated in Canada after April 26, 1965 is deemed to be resident in Canada for the purposes of the *Income Tax Act*.

Income earned by a non-resident that is not subject to ordinary income tax may still be subject to a withholding tax at a rate of 25% (unless reduced or eliminated by an applicable tax treaty) on certain Canadian source income. This includes management fees, interest, dividends, rent royalties and some distributions from trusts. An amendment to the *Income Tax Act* eliminates withholding tax on most interest payments paid to persons dealing at arm's length with the payer.

Canada has entered into over 85 income tax treaties with other jurisdictions. These tax treaties generally provide that the business profits of a non-resident of Canada that is a resident of the other jurisdiction are not subject to tax under the *Income Tax Act*, except to the extent that such profits are attributable to a permanent establishment (i.e., a fixed place of business) of the non-resident in Canada. These tax treaties also usually reduce both the withholding tax rate imposed under the *Income Tax Act* and the branch-profits tax rate.

USEFUL RESOURCES

Government of Canada

- Canada Revenue Agency
- Department of Finance
- *Income Tax Act*

View our disclaimer at osler.com/disclaimer.

Amendments to the Canada-U.S. Tax Convention eliminate withholding tax on almost all interest, including interest paid between related persons. In addition, these amendments address "treaty shopping" by ensuring that treaty benefits are only available to residents of Canada or the U.S. that satisfy certain tests. The provinces generally adhere to (although they are not bound by) the provisions of the treaties.

The Income Tax Act deems related persons to not deal with each other at arm's length; whether unrelated persons deal with each other at arm's length is a question of fact . Under the transfer pricing rules, a Canadian taxpayer and a non-arm's length non-resident must conduct their transactions in a manner similar to that which would have applied had the parties been dealing at arm's length. If the terms and conditions of the non-arm's length transaction differ from those that would have prevailed between arm's length person s, the rules provide that the terms and conditions may be adjusted to reflect those that would have existed had the parties been dealing at arm's length.

The Income Tax Act's general anti-avoidance rule allows the re-characterization of transactions and amounts in certain circumstances where taxpayers have entered into tax-motivated transactions that result in a misuse or abuse of the provisions of the *Income Tax Act*.

RELATED TOPICS

- Initial structuring and income tax considerations
- Branch of a foreign corporation vs. Canadian subsidiary
- Commodity taxes
- Thin-capitalization rules
- Branch profits tax

Need more info?

Osler's Tax Group team can help. Find out more at **osler.com/tax**