The International Comparative Legal Guide to: Corporate Tax 2012
A practical cross-border insight to corporate tax work

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General Chapters:

1 UK Holding Companies and CFC Reform - William Watson, Slaughter and May 1
2 Gazing in the Crystal Ball: The State of Corporate Tax Reform in the United States - Dan A. Kusnetz, Schulte Roth & Zabel LLP 5

Country and Question Answer Chapters:

3 Albania KALO & ASSOCIATES: Aigest Milo & Ardjana Shehi 15
4 Andorra Arqués Ribert Junyer Advocats: Daniel Arques i Tomàs & Mireia Ribó i Bregolat 19
5 Argentina Negri & Tejeiro Abogados: Guillermo O. Tejeiro & Ana Lucia Ferreyra 25
6 Australia Greenwoods & Frehllid: Adrian O’Shannessy & Andrew Mills 33
7 Austria Dorda Brugger Jordis: Paul Doralt & Martina Znidaric 39
8 Belgium Clifford Chance LLP: Thierry Blockerye & Pierre-Olivier van Cauberg 45
9 Bulgaria Georgiev, Todorov & Co.: Georgi Kostolov 53
10 Canada Thorsteinsons LLP: Michael Colborne & Michael McLaren 58
11 China Henderson Taxand: Dennis Xu & Eddie Wang 63
12 Cyprus Dr. K. Chrysostomides & Co LLC: Dr. Kypros Chrysostomides & George Ioannou 68
13 Czech Republic Salans: Petr Kotáb 72
14 Denmark Gorrissen Federispil: Lars Fogh & Jakob Skaadstrup Andersen 78
15 Estonia Aivar Piel Law Office: Jaak Siim & Ilmar-Erik Aavakivi 84
16 Finland Hannes Snellman Attorneys Ltd: Ossi Haapaniemi & Outi Raitasuo 92
17 France Bredin Prat: Yves Rustemmann & Marion Méresse 97
18 Germany P+P Pöllath + Partners: Richard Engl & Gerhard Specker 103
19 Greece KGDi Law Firm: Elisabeth Eleftheriades & Panagiotis Pothos 109
20 Iceland LOGOS legal services: Bjarnfredur Olafsson 116
21 India ALMT Legal: Aliff Fazelbhoy & Ashta Chandra 120
22 Ireland McCann FitzGerald: Michael Ryan & Eleanor MacDonagh 126
23 Israel Herzog Fox & Neeman: Meir Linzen & Eldar Ben-Ruby 132
24 Italy CBA Studio Legale e Tributario: Paolo Omodeo Salè & Nicoletta Mazzitelli 138
25 Japan Nagashima Ohno & Tsunematsu: Yuko Miyazaki 145
26 Korea Yoon & Yang LLC: Seung-Soon Lim & Tae-Hwan Oh 152
27 Kosovo Boga & Associates: Alketa Uruçi & Andi Pacani 158
28 Lithuania Juridicon Law Firm: Laimonas Marcinkevičius & Ingrida Steponavičienė 162
29 Luxembourg Elvinger, Hoss & Prussing: Pierre Elvinger & Dirk Richter 170
30 Macedonia Debarliev, Dameski & Kelesoska Attorneys at Law: Dragan Dameski 177
31 Malta Avanza Taxand Limited: Walter Cutajar & Mary Anne Anguenne 181
32 Nigeria Banwo & Ighodalo: Akinbode Akeredolu & Dipo Ogunbido 188
33 Norway Bugge, Arentz-Hansen & Rasmussen (BA-HR): Frode Talmo & Joachim M Bjerve 192
34 Poland Gide Loyrette Nouel Warsaw Office: Ewa Opalińska & Maciej Grela 198
35 Romania Pachiu & Associates: Andrei Dumitrache & Vlad Rădoi 203
36 Slovakia White & Case LLP: Matej Firický & Tomáš Cibula 210
37 Slovenia Leitner & Leitner, d.o.o.: Blaž Pate 215
38 Spain Cuatrecasas, Gonçalves Pereira: Alejandro Escoda & Andreas Trost 220
39 Sri Lanka Nithya Partners: Naomal Goonewardena & Sheranaka Madanayake 227
40 Switzerland Lenz & Staeelin: Heini Rüdisühl & Jean-Blaise Eckert 232
41 Ukraine B.C. Toms & Co: Bate C. Toms & Mykhailo Razumai 240
42 United Kingdom Slaughter and May: William Watson & Zoe Andrews 247
43 USA Proskauer Rose LLP: Stuart L. Rosow & Amanda H. Nussbaum 253
44 Vietnam Gide Loyrette Nouel A.A.R.P.I.: Samantha Campbell & Phan Thi Lieu 261

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1 General: Treaties

1.1 How many income tax treaties are currently in force in Canada?

Canada currently has 89 treaties that are in force, 6 treaties are signed but not yet in force and 16 treaties that are either under negotiation or re-negotiation. In addition, Canada currently has 3 tax information exchange agreements that are in force; 12 that are signed but not yet in force and 14 under negotiation.

1.2 Do they generally follow the OECD or another model?

Canada’s tax treaties generally follow the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

In order to come-into-force, a treaty must be incorporated into domestic law by way of a bill passed in Parliament.

1.4 Do they generally incorporate anti-treaty shopping rules (or “limitation of benefits” articles)?

Canada’s tax treaty with the U.S. has a specific limitation of benefits rule that is derived from the limitation of benefits rule in the U.S. model treaty. Additionally, some of Canada’s treaties have narrow limitation of benefits provisions, e.g., benefits are not available to certain types of entities.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

While treaties cannot be overridden by domestic legislation, the general anti-avoidance rule in the Income Tax Act can be applied to eliminate treaty benefits if a court concludes that a tax treaty has been abused.

2 Transaction Taxes

2.1 Are there any documentary taxes in Canada?

There are no documentary stamp taxes in Canada.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Canada has a 5% federal VAT, called the goods and services tax (GST). Many provinces have harmonised their commodity tax regime with the GST. In the “harmonised” provinces, an additional provincial tax is collected alongside the GST at rates, ranging between 7% and 10%. The combined tax is referred to as the “Harmonised Sales Tax”. However, some provinces retain a transactional sales tax at between 5% and 10%. Quebec’s sales tax mirrors the federal GST, but is imposed by separate provincial statute. The province of Alberta does not levy any type of VAT or sales tax.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

While the GST is a comprehensive tax on goods and services, like many countries it does not apply to all transactions. The legislation lists a variety of sectors where, for policy reasons, no tax is charged. For example, the transfer of shares or debt and the provision of many types of financial services are not subject to GST.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

The GST is generally recoverable by all businesses. There are exceptional cases, however, particularly among the sectors where tax is not charged. For example, businesses engaged in the provision of financial services have limited recovery of the GST.

2.5 Are there any other transaction taxes?

Each province levies a variety of transaction taxes, the principal ones being imposed on alcohol, tobacco, and land transfers. In addition, some municipalities and cities levy a land transfer tax.

2.6 Are there any other indirect taxes of which we should be aware?

There are a number of other indirect taxes that are noteworthy. At the federal level, payroll taxes in the form of employment insurance premiums and pension plan contributions are paid by employers and employees. In addition, some provinces have additional payroll taxes (e.g., the Employer Health Tax in Ontario). The federal government also imposes indirect taxes on commodities such as fuel, alcohol and tobacco and certain forms of insurance.
The tax base upon which the corporate tax is levied is determined under the principles of double taxation.
in accordance with specific statutory rules. The starting point for the calculation is the company’s profit, as determined under general commercial principals. After profit is determined, specific adjustment rules in the Income Tax Act for both income inclusion and expense deduction apply to determine income.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

A corporation’s tax profit will often differ significantly from its financial statement income. For example, no “reserve” amounts are permitted unless specifically authorised in the Income Tax Act, and there are very few reserves so provided. Additionally, depreciation and depletion rates for assets and mineral, timber and oil and gas properties differ significantly from financial statement income. These are but a few of the examples of the differences between commercial accounts and tax accounts.

4.5 Are there any tax grouping rules? Do these allow for relief in Canada for losses of overseas subsidiaries?

Under current law there is no consolidation or tax grouping regime. Instead, in-group tax relief is effected by way of “loss consolidation” transactions, using interest expense or undeducted depreciation expenses. These transactions are well understood and are not considered abusive by the tax authorities. Canada is actively considering introducing a loss transfer regime so that taxpayers do not have to rely on the ad hoc system currently in place.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

A corporation’s tax rate is the same regardless of whether profits are distributed or retained. Note that certain corporations pay an additional tax on portfolio and investment income, which is refundable when dividends are paid. These rules are not relevant to most non-resident investors.

4.7 Are companies subject to any other national taxes (excluding those dealt with in “Transaction Taxes”) - e.g. tax on the occupation of property?

Some provinces have a capital tax, which is a tax on the net “wealth” of a corporation determined on a balance sheet basis. The federal capital tax has been repealed.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are many local business taxes and miscellaneous taxes (e.g., oil and gas royalties and mining taxes). Each province must be examined on a case-by-case basis to determine if the activities would attract the tax.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

Canada provides a base preference for capital gains. That is, one-half of a capital gain is included in income and is taxed at ordinary rates. Capital losses may only be used to offset capital gains, and may be carried back three years and forward indefinitely.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

As noted above, Canada provides a base, not a rate, preference for capital gains. Therefore, one-half of realised capital gains are included in income and taxed ordinary rates.

5.3 Is there a participation exemption?

Canada does not have a participation exemption for capital gains.

5.4 Is there any special relief for reinvestment?

There is no special relief for reinvestment.

6 Local Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

No stamp, capital or wealth duties are imposed on the formation of a subsidiary. As noted above, some provinces have retained a capital tax.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

There are no such significant taxes.

6.3 How would the taxable profits of a local branch be determined?

The taxable profits of a local branch of a foreign company are determined in the same manner as a Canadian-resident company.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Canada levies a branch profit tax of 25% on branch profits that are considered withdrawn from Canada under a statutory formula. In this connection, amounts reinvested in Canada as determined by detailed statutory and regulatory rules may reduce the amount of branch profits that are considered withdrawn from Canada.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

Under the Income Tax Act, the branch tax rate is generally reduced where the corporation is a resident of a country that has a tax treaty with Canada, which reduces withholding tax rates on dividends. The applicable rate is that which applies where a non-resident corporation owns all of the shares of a Canadian-resident company (this will often be 5%). In addition, some of Canada’s tax treaties exempt the first $500,000 of a non-resident corporation’s Canadian-source income from the branch tax base where such corporation qualifies for benefits under the relevant treaty.
6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

There is no other tax that would be imposed a consequence of remitting profits by the branch of the head office.

7 Overseas Profits

7.1 Does Canada tax profits earned in overseas branches?

Canadian residents are liable to Canadian tax on their worldwide income. Consequently, a Canadian-resident company will be subject to Canadian tax on profits earned from overseas branches. The *Income Tax Act* allows a foreign tax credit for foreign taxes paid. In computing the credit there are two income “baskets”; business income and non-business income. In addition, the credit is computed on a country-by-country basis, so that credits for foreign tax paid to one country cannot be used to reduce Canadian tax on foreign-source income from another country.

7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

In effect, the *Income Tax Act* exempts dividends received by a Canadian resident from “foreign affiliates” if the dividends are derived from active business profits earned by a foreign affiliate that is resident in a country with which Canada has a tax treaty or tax information and exchange agreement and the profits are earned by the affiliate through a permanent establishment in such a country. The foreign affiliate rules are complex, and are linked with Canada’s controlled foreign corporation rules (discussed below).

7.3 Does Canada have “controlled foreign company” rules and if so when do these apply?

Canadian resident taxpayers that own shares of a “controlled foreign affiliate” at the end of a taxation year of the affiliate ending in a taxation year of the taxpayer are required to include certain types passive income and capital gains (“foreign accrual property income”) in computing the taxpayer’s income for the year. Where the taxpayer is a Canadian-resident taxpayer, the foreign accrual property income rules work in concert with the foreign affiliate rules mentioned above.

8 Anti-avoidance

8.1 Does Canada have a general anti-avoidance rule?

Canada has had a statutory general anti-avoidance rule since 1988. There is now a substantial amount of jurisprudence considering the application of the rule.

8.2 Is there a requirement to make special disclosure of avoidance schemes?

The province of Quebec requires reporting of certain types of tax avoidance transactions if certain conditions are met. In addition, the federal government in its March 4, 2010 Federal Budget released draft proposals to require the reporting of certain tax avoidance transactions. Although draft legislation to implement the draft proposals has been released, it is our understanding that the consultation process is not complete.
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Michael’s practice focuses on corporate and international tax planning, regularly advising Canadian and foreign-based multi-national groups on a variety of matters, including inbound and outbound investment and financing, mergers and acquisitions, divestitures, and natural resource taxation. Michael also has considerable experience in handling tax controversy issues faced by multi-national groups in Canada and a number of other countries. Michael has appeared in the superior courts of British Columbia and Ontario, the Tax Court of Canada, the Federal Court of Appeal, the Supreme Court of Canada and before the Revenue Tribunal of the United Republic of Tanzania.

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