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Canadian Tax Rates, Not quite a Tax Haven

Canada has not historically been known for its favourable levels of taxation. However, in the course of the past decade, corporate tax rates have been steadily reduced with the result that favourable rates of taxation are incurred by corporations with business income in Canada. Indeed, it is likely that significantly lower corporate tax rates will remain in place in Canada as compared with the United States in the near to medium term. Moreover, a favourable tax treaty (the "**Treaty**") provides both certainty and a variety of methods for efficiently repatriating profits to the United States. For these reasons, this may be the most attractive time in decades to consider expansion and business opportunities in Canada.

This update will provide a brief overview of the taxes incurred by a corporation subject to tax in Canada.

Taxes are levied at the Federal and Provincial level in Canada, with administration handled by the Federal government (other than in the provinces of Alberta and Quebec which separately manage their provincial taxes). For this reason, United States businesses often find that compliance obligations are more streamlined in Canada than in some US states, in which complex parallel state taxation systems can often be as time-consuming as federal compliance.

There are some important differences between the United States and Canadian taxation systems. The following is a brief but not necessarily all inclusive list:

- In Canada one half of any capital gain is added in computing taxable income and taxed at the relevant rate. This rule applies equally to corporations and to individuals.

- Losses of a Canadian corporation enjoy generous carry forward and carry backwards provisions. Current year income losses are available in the three preceding and 20 subsequent taxation years. Capital losses (which can only offset capital gains) can be carried forward indefinitely and are available for three years of carry back.

- Each corporation with Canadian source income must file a tax return. Canada does not have a system for consolidating returns.

- Canada's thin capitalization rules deny interest expense where related party debt exceeds equity by more than 2 to 1.

Combined corporate tax rates vary between the provinces, and are set out in the attached appendix. In British Columbia, combined corporate taxation rates as of January 1st, 2012 are 25%. As noted above, interest expense is deductible in computing taxable income and, subject to thin capitalization rules, inter-group debt is often an effective method of providing a return to a United States parent as interest incurs withholding taxes at a rate of 0% under the Treaty.

Dividends may, in most inter-corporate holding arrangements, be returned to the United States out of after-tax Canadian income at a rate of 5% withholding tax. Returns of capital contributed by a shareholder can be made without incurring withholding tax whether or not the Canadian corporation has earnings or profits. The branch tax rate is also reduced under the Treaty to 5%. Thus, the effective rate to remove income out of Canada (income tax and withholding or branch tax) is 28.75%.

As a result of the favourable taxation treatment of Canadian corporations, a stable and growing economy and sustained growth in the many resources sectors of the Canadian economy, it is an ideal time for United States corporations and investors seeking expansion opportunities to consider expansion or investment into Canada.

For more information please contact Len Glass at 604.631.9140 or lglass@lawsonlundell.com.

Appendix

Province/Territory 2012	Combined Rate of Tax on General Income
Alberta	25
British Columbia	25
Manitoba	27
New Brunswick	25
Newfoundland and Labrador	29
Northwest Territories	26.5
Nova Scotia	31
Nunavut	27
Ontario	26.5 (26 effective Jul 1, 2012)
Prince Edward Island	31
Quebec	26.9
Saskatchewan	27
Yukon	30

*in some provinces, but not British Columbia, these general rates may vary slightly for certain sources of income (e.g. income from manufacturing and processing, or investments income).