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Introduction

A variety of legal arrangements may be used to carry on a commercial activity in Canada. These include sole proprietorship, partnership, limited partnership, corporation, franchise and joint venture. As well, there are legal methods of carrying on non-profit activities; groups having objects of a religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character may operate as unincorporated associations or non-profit corporations. This chapter will discuss the legal characteristics of a corporation with share capital which is the business entity used most frequently to carry on commercial activities in Canada.

The Corporation and Shareholder Liability

A corporation is a legal entity separate in law from its owners, the shareholders of the corporation. A corporation may own property, carry on business, incur liabilities, and possess rights such as the right to sue in its own name. A corporation has perpetual existence beyond the lifetimes of its shareholders, officers and directors; it exists until it is dissolved. The shareholders own the corporation through their ownership in shares but do not own the business or the property belonging to the corporation, and the rights and liabilities of the corporation are not the rights and liabilities of the shareholders. The shareholders are said to have "limited liability" because their liability in connection with the property or business owned by the corporation is limited to the value of the assets (money, property or services) they have transferred to the corporation in exchange for shares in the corporation. A shareholder's liability to creditors of the corporation is limited to the amount of his or her investment and his or her personal assets are shielded from being used to satisfy the liabilities of the business. However, if a corporation requires financing, personal guarantees from major shareholders are often required before lenders such as banks will make loans to a corporation, particularly if it has few assets of its own. Such guarantees can expose a shareholder's personal assets. Normally, though, not all corporate debts will be guaranteed by the shareholders as, for example, debts to trade creditors.

Statutes that Govern Corporations

Canada has a federal system of government, and it is therefore possible to incorporate at either of two levels:

- federally, under the Canada Business Corporations Act ("CBCA"); or
- provincially, under the relevant legislation in each province, such as the Business Corporations Act of Ontario ("OBCA").

Once having chosen the corporation as the appropriate form of business entity, one must consider in which jurisdiction to incorporate. For the purpose of this chapter, it will be assumed that the choice is only between the Federal and Ontario jurisdictions.

The CBCA provides for incorporation as of right by Articles of Incorporation. A federal corporation may, subject to the licensing requirements (if any) of each province, carry on business anywhere in Canada and use its name in any province as of right. The minimum required number of directors is one (except for companies offering securities to the public which must have at least three directors of which at least one third must not be officers or employees of the corporation or any of its affiliates), but there is a requirement that at least 25% of directors be resident in Canada and either be Canadian citizens or, in certain circumstances, permanent residents. This is the case even if a company is foreign controlled. However, in the case of a holding company earning less than 5% of its consolidated revenue in Canada, only one-third of the directors need be resident Canadians.

Ontario corporations are also incorporated by Articles of Incorporation to which the applicants are entitled as of right. An Ontario corporation can carry on business in the province of Quebec without obtaining an extra-provincial license. Ontario corporations, however, must either register or obtain an extra-provincial license in order to carry on business in any other province and, unlike a federal

corporation, this registration or license may not be granted if the name of the Ontario corporation is not acceptable in the province where application for the registration or license is being made. An Ontario corporation not offering its securities to the public need have only one director, who need not be a shareholder. The by laws of the corporation may provide that the president need not be a director. However, contrary to the CBCA, a majority of the directors of an Ontario corporation must be "resident Canadians" - a requirement which may prove to be more onerous for a foreign corporation looking to establish a Canadian subsidiary. Furthermore, in the context of an Ontario corporation, a majority of the directors' meetings must be held in Canada and a majority of the directors present at any meeting must be resident Canadians. A resident Canadian is defined in the legislation as an individual who is resident in Canada and is either a Canadian citizen or, in certain circumstances, a permanent resident.

Branch Operation

It is possible to do business in Canada without incorporating by carrying on business through a branch operation. A foreign enterprise need not incorporate a company in Canada in order to carry on business in this country. If it chooses not to incorporate in Canada, then it could carry on business through a "branch operation". In that case, it would be required to register as an "extra provincial corporation" in Ontario and in any other province in which it carries on business. Depending on the nature of the activities undertaken, such registration may be required even if the corporation does not have a "permanent establishment" in the province for income tax purposes. While there is provision for penalties for failure to register, we know of no instance where such provision has been invoked and a penalty levied. If unregistered, however, an extra provincial corporation is not capable of registering an interest in land or maintaining a proceeding in a court in Ontario in respect of any contract made in whole or in part in Ontario in connection with business carried on in Ontario. It should be noted that if a company carries on business in Canada through a branch, it is required to keep books and accounting records at the Canadian place of business and to open such records upon request for audit by Canadian taxation authorities.

Process of Incorporation

Incorporation under both the CBCA and OBCA is accomplished by delivering Articles of Incorporation in the form prescribed in the regulations to the appropriate government department, together with the required supporting material and the required fees. The Articles must contain the following information about the corporation: name, registered office address; number of directors and the name(s) of the first director(s); restrictions (if any) on the nature of the business that can be carried on by the corporation; the corporation's capital structure; and restrictions (if any) on the transfer of shares. On receipt of the Articles conforming to the applicable statute, the applicable government issues a Certificate of Incorporation to the corporation and the corporation comes into existence on the date shown in the Certificate. Once the Articles have been processed, both the CBCA and OBCA require that certain corporate records must be kept including a copy of the Articles, all by-laws, all amendments thereto, a copy of any unanimous shareholder agreement known to the directors, minutes of meetings and resolutions of shareholders, a register of directors, a securities register, adequate accounting records, records containing the minutes of meetings and resolutions of the directors and any committee thereof and a register of transfers. Except for the Articles, the corporate records are not public documents.

It is normal to prepare, as By-law No. 1 of the corporation, a general by-law dealing with meetings, notice, quorum (i.e. the number of directors or shareholders required to constitute a meeting), officers, proxies, execution of documents and other matters of a continuing nature. The purpose of this general by-law is to fix the general rules governing the operation of the corporation. However, anything that could be the subject matter of a by-law may be put in the Articles of a corporation. It is customary, for instance, to include in the Articles of Federal and Ontario corporations borrowing powers and the powers to mortgage, charge and hypothecate property.

The corporation may change the corporate characteristics set out in its Articles such as the corporation's capital structure. The general rule is that the Articles can be amended only by means of a special resolution passed by the shareholders. After a special resolution amending the articles of a corporation

has been passed, Articles of Amendment that contain the amendment must be sent to the appropriate government department, which will then issue a Certificate of Amendment to the corporation. There are a few exceptions to the general rule that a corporation's articles must be amended by a special resolution. For example, a change in the directors or in the address of the registered office does not require an amendment to the Articles. Instead, only a notice of such changes is sent to the appropriate government department.

Unless the Articles, by-laws or a unanimous shareholder agreement provide otherwise, the directors may make, amend or repeal any by-laws that regulate the business or affairs of a corporation. A by-law or an amendment or repeal of a by-law is effective as soon as a directors' resolution is passed at a meeting or signed by all the directors. Once the directors make, amend or repeal a by-law, they must submit it to the shareholders at the next meeting of shareholders who may confirm, reject or amend it. If a by-law or an amendment or repeal of a by-law is rejected by the shareholders, or if the directors do not submit the by-law, amendment or repeal to the shareholders, it ceases to be effective on the date of rejection or on the date of the meeting of shareholders to which it should have been submitted. A by-law or an amendment to or repeal of a by-law may also be proposed by any shareholder entitled to vote at a meeting of shareholders. If the by-law, amendment or repeal is passed at a meeting of shareholders, it is effective from the date of such adoption. No action by the directors is required. An ordinary resolution of shareholders is required to approve or confirm a by-law or an amendment or repeal of a by-law. If a greater majority is considered desirable, provisions which would normally go into the by-laws can be placed in the Articles, in which case a special resolution of shareholders will be required.

CBCA and OBCA corporations must file annual information returns with the appropriate government department.

Share Capital

The corporation can be incorporated with only one class of shares, which may be designated "common", "Class A", etc. Where a corporation has only one class of shares, the rights of the holders thereof are equal in all respects and

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include the rights to vote at any meeting of shareholders of the corporation, to receive the remaining property of the corporation on dissolution and the right to receive dividends when declared. However, the Articles may provide for more than one class of shares, with the rights, privileges, restrictions and conditions attaching to the shares of each class set out therein. Where there is provision in the Articles for more than one class of shares, it is important to note that each of the rights set out above must be attached to at least one class of the authorized shares, but all of the rights are not required to be attached to any one class. For example, holders of "Special" or "Preference" shares might have no right to vote at shareholders' meetings but may have the right to receive dividends and return of property upon dissolution of the corporation before the common shareholders. However, the OBCA and CBCA grant voting rights to non-voting shares in certain circumstances; fundamental changes to the corporation including a variation of shareholder rights, an amalgamation, an arrangement, or the sale of all or substantially all of the corporation's assets must be approved by the shareholders by a "special resolution" passed by a majority of not less than two-thirds of the votes cast by each shareholder.

The number of shares of each class which a corporation may issue will be unlimited unless a maximum number is specified in the Articles. Neither jurisdiction restricts the manner in which the shares of any class or series may be designated or, except as mentioned above, attaches mandatory rights or conditions to any class of shares. The Articles may authorize the issue of a class of shares in one or more series (e.g. Preference shares designated as "Series A", "Series B", etc.), and may authorize the directors to fix the number of shares in, and to determine the designation, rights, privileges, restrictions and conditions attaching to the shares of each series. Most corporations (other than publicly offered corporations) have tight restrictions on the transfer of shares. Such restrictions are usually found in the Articles as well as in shareholder agreements. Typically, the consent of at least the majority of shareholders or directors is required before a share transfer in a private corporation is permissible. Subject to the Articles, the by-laws and any unanimous shareholder agreement, the directors may issue shares at any time and to such persons and for such consideration as they determine and may declare dividends at any time.

Meetings of Directors and Shareholders

Once the corporation is organized, even if directors meet irregularly, it is customary for them to meet once a year prior to the annual shareholders' meeting to approve the corporation's financial statements so that they can be presented to the shareholders (shareholders do not technically approve the financial statements). The shareholders would then meet to receive the financial statements, elect new directors, appoint auditors (if required) for the next year, and pass resolutions dealing with any other matters referred to in the notice of the meeting of shareholders. Shareholders may elect directors for a term not exceeding three years. A director not elected for an expressly stated term ceases to hold office at the close of the first annual meeting of shareholders following his or her election. However, if no directors are elected at a meeting of shareholders, the incumbent directors continue in office until their successors are elected. After the shareholders' annual meeting, the newly-elected directors would meet to elect the president and other officers of the corporation. Directors are authorized to fix the remuneration of the directors, officers and employees of the corporation. The directors' discretion in this regard may be limited by provisions in the Articles, the by-laws or a unanimous shareholder agreement.

Except where the articles or the by-laws of the corporation provide otherwise, the majority of the meetings of the directors of an Ontario corporation in any year must be held in Canada. There is no similar CBCA requirement. Under both the OBCA and CBCA this requirement is not applicable where a written resolution is used, signed by all of the directors entitled to vote on that resolution (shareholders may also pass a resolution with the consent in writing of all of the shareholders in lieu of a meeting). Meetings of shareholders of CBCA corporations must be held in Canada unless all shareholders agree to a meeting outside of Canada. For an OBCA corporation, the directors, subject to the Articles and any unanimous shareholder agreement, may determine the place of the shareholders meeting, failing which it will be held at the corporation's registered office in Ontario.

Directors' and Officers' Duties and Liabilities

The following is not meant to be an exhaustive review of possible sources of liability for directors and officers, but is merely intended to convey an impression of the scope of such liability.

A director's duty is owed first and foremost to the corporation. Both legislative statutes and the common law establish the parameters of a director's duties. Some of these duties and obligations, specifically, the fiduciary duty, the standard of care and some of the statutory liabilities, apply with equal force to officers. It is the duty of the directors to manage or supervise the management of the business and affairs of a corporation. Unless provided for in a unanimous shareholder agreement, the shareholders of a corporation cannot usurp the directors' power to manage the corporation. Of course, shareholders can also be directors of a corporation, in which case, they will have the ability to control and operate the corporation and shareholders can exercise indirect control over the business and affairs of the corporation since they elect the directors.

The CBCA and OBCA set out the standard of care required of directors and officers, which is essentially a codification of the case law. Every director and officer must act honestly and in good faith with a view to the best interests of the corporation, and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. This duty recognizes that directors and officers are in a position of trust over the actions of a corporation. In effect, the legislation imposes a "fiduciary duty" on directors and officers of a corporation in the management and operation of a corporation. In this regard, directors and officers cannot engage in certain activities such as, putting their personal interests in conflict with the best interests of the corporation or taking a corporate opportunity for personal profit that a corporation either could have obtained for itself or was actively seeking. Directors and officers also have a duty to disclose their interest in a material contract or transaction of the corporation. These duties are absolute; directors and officers cannot excuse themselves from their fiduciary obligations and the minimum standard of care by way of contract, the Articles, the by-laws or any shareholders' resolution.

In addition to directors' and officers' fiduciary duties and the standard of care which they must observe, there are other specific statutory liabilities imposed upon directors personally. Many of these specific liabilities are imposed upon directors for making errors which could have an adverse effect on the financial position of the corporation. For example, under both the CBCA and OBCA, directors may not declare a dividend if there are reasonable grounds for believing that after the payment of the dividend, the corporation would become insolvent. If directors pay dividends in these circumstances, they will normally be jointly and severally liable for the amount of dividends paid and not recovered by the corporation. Other errors that expose directors to liability include liability for authorizing: the issue of share for inadequate consideration; an improper loan; payment or an improper indemnity; an improper payment to a shareholder; an improper commission; and an improper redemption, purchase or other acquisition of shares.

A director is not liable for breach of fiduciary duty, the standard of care or for any specific liability discussed above, if the director acted in good faith in reliance upon financial statements of the corporation which an officer of the corporation or the auditor represents to reflect fairly the financial condition of the corporation, or upon a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by such a person.

Another important statutory liability imposed on directors is personal liability for as much as six months' wages of employees together with as much as 12 months' vacation pay. If a corporation becomes insolvent, this obligation can result in a significant financial hardship for the corporation's directors.

There are many other statutes which impose civil and criminal liability on directors and officers of a corporation for outstanding liabilities and obligations of a corporation. Most of these are related to matters such as taxation, the environment, employees and reporting requirements.

Public Companies

All Canadian provinces have some form of legislation (such as the Securities Act and the regulations made thereunder in Ontario) restricting sales and other

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forms of dealing of securities to the public. The term "securities" is broadly defined and includes the shares of a corporation as well as many debt instruments such as bonds and options to acquire shares, etc. In order to trade in a security, a corporation must be registered with the appropriate regulatory body (in Ontario, this would be the Ontario Securities Commission (OSC)) and comply with all the statutory rules and conditions imposed by the regulatory body. Thus, a "publicly offered" corporation (for example, a corporation whose shares are listed for trade on a stock exchange) must comply with all statutory laws and conditions imposed by the appropriate regulatory body. Failure to comply can lead to high monetary penalties and criminal conviction.

The process for becoming a "publicly offered" corporation is long and expensive. In addition to the registration requirement, the distribution of securities requires the preparation and filing a "prospectus" with the regulatory body. A prospectus is a comprehensive disclosure document which is intended to provide full, true, and plain disclosure of all material facts in respect of the securities offered by the corporation. It is a long and complex document, which often requires the work of accountants, lawyers and business consultants to prepare. It includes information about the corporation, a description of the share capital and the class of share to be sold including its price. The prospectus must also contain historical audited financial statements. Only once the prospectus has been filed and receipts have been issued for it by the regulatory body may the securities be sold to the public. The information contained in a prospectus must also be continually updated to remain accurate. Thus, "publicly offered" corporations or "public companies" are required to comply with the requirements for continuous disclosure. The continuous disclosure regime primarily deals with the publication and distribution of financial information on an ongoing basis and the preparation of informational documents in conjunction with meetings of shareholders. In addition, public companies are required, where a "material change" occurs in the affairs of a reporting issuer, to forthwith issue and file a press release authorized by a senior officer, disclosing the nature and substance of the change, and thereafter file a "material change report". "Materiality" is found to exist where the event would reasonably be expected to have a significant effect on the market price or value of the securities of the reporting issuer or, in other contexts, an event may be material where disclosure of the

event would reasonably be expected to have a significant influence on a reasonable investor's investment decision.

Most securities laws have certain exemptions whereby one would not have to meet all the requirements demanded of a "publicly offered" corporation. In particular, most securities laws have an exemption for "private" corporations. This is known as the "closely-held issuer" exemption in Ontario which has the following characteristics:

- The incorporating or constating documents of the corporation restrict the rights of shareholders to transfer their shares (requiring the approval of either the board of directors or the shareholders); and
- The total number of shareholders of the corporation does not exceed 35, excluding shareholders who either are, or were at the time they last acquired shares of the company, "accredited investors" (discussed below) and excluding current and former directors, officers or employees of the company, or current or former consultants who received shares pursuant to compensation or incentive arrangements.

Thus, most small to mid-size corporations are able to allow sales and transfers of shares by meeting the above requirements.

The "accredited investor" exemption in Ontario permits companies to raise any amount of investment at any time from any number of accredited investors who purchase securities for their own account. Accredited investors are presumed capable of making an investment decision without the assistance of a prospectus or the advice of a registered dealer. Accredited investors include individuals, either alone or with a spouse, who have financial assets (generally cash or securities but not real estate or non-financial personal property) with value over $1 million (Cdn.); individuals with net income in each of the last two calendar years over $200,000 or $300,000 (Cdn.) in conjunction with a spouse and a reasonable expectation of the same level in the current year; and, corporations, partnerships, limited partnerships or other entities with net assets of at least $5 million (Cdn.).

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Taxes on Corporate Income

In Canada, corporations may be subject to both federal and provincial income taxes. Unlike individuals, which are subject to progressive tax rates, corporations are subject to a flat rates of tax. The rates of tax depend on the type of corporation and the source of its income. The federal income tax payable by a corporation pursuant to the Income Tax Act (Canada) (the "Tax Act") is comprised of the basic federal corporate rate and the federal corporate surtax. The basic federal corporate rate is 38% minus a provincial abatement of 10%. However, this abatement only applies where a corporation earns income that is attributable to any province in Canada. In 2004, the basic federal rate after applying the provincial abatement was reduced to a net rate of 21%, but only on certain income, excluding income from manufacturing and processing and investment income. A surtax of 4% is levied on the basic federal tax payable (after the provincial abatement) by all corporations. All taxable Canadian corporations and other corporations with permanent establishments in Canada with taxable capital employed in Canada in excess of $50 million are subject to the Large Corporations Tax (LCT). The rate of tax is 0.175%. The federal budget of February 18, 2003 has proposed to eliminate the LCT for all corporations by 2008. The federal budget of February 23, 2005 has proposed to eliminate the aforementioned surtax.

In Ontario, a provincial tax of 11% is imposed under the Corporations Tax Act (Ontario) on corporations which have a permanent establishment in the province. A corporation will have a permanent establishment in a province if it has a fixed place of business there. It may also have a permanent establishment in certain other circumstances, such as when it carries on business through an employee or agent, or uses substantial machinery or equipment in a province.

Corporate Residence

Under the Tax Act, a non-resident corporation which carries on business in Canada is subject to Canadian income tax on the portion of its worldwide income earned in Canada. However, Canada has entered into numerous tax treaties which may affect the foregoing principle, for example by providing that the business profits of corporations resident in a treaty country are only subject to tax in Canada if they are attributable to a permanent establishment in Canada. The application of branch taxes is usually subject to modification in Canada's international tax agreements.

A Canadian subsidiary incorporated in Canada after April 26, 1965, or prior to that date if it carried on business or was resident in Canada at any time thereafter, is considered to be resident in Canada for tax purposes and is taxed in Canada on its world income regardless of where such income is earned. The subsidiary is subject to Canadian federal income tax as well as provincial income tax in any province in which the company maintains a permanent establishment.

Other Taxes

SALES TAXES

Sales taxes are imposed by federal legislation and also by all provincial governments with the exception of Alberta. In Ontario, with certain exceptions, the rate of tax, which is imposed on tangible property acquired for personal consumption or use, as well as on a few services relating to such property, is 8%.

Since 1991, Canada has had a value-added sales tax on goods and services ("GST"), which is provided for in the Excise Tax Act (Canada). GST is imposed at a rate of 7% on the consideration paid in respect of virtually all goods and services provided in Canada. Generally, the tax is paid by the purchase of the good or service to the vendor, who collects the tax on behalf of the government. The vendor is entitled to claim a credit for the GST paid by the purchaser in respect of the GST the vendor itself paid on goods or services acquires for the conduct of the vendor's commercial activity in Canada. The difference between the total amount collected by the vendor from its clients and the total amount paid by the vendor to it suppliers is remitted to the tax authorities. In the case of goods imported into Canada, the GST is paid to the taxing authority directly, based on the duty-paid value of the goods, with an off-setting credit available to a registered importer in respect of the GST paid, provided the goods are used by the importer in a commercial activity in Canada.

No GST is paid on basic groceries, prescription drugs, medical and educational services and residential rents.

EXCISE TAXES

The Excise Tax Act (Canada) provides for excise taxes on four products imported into or manufactured in Canada: beer, wine, alcohol and tobacco. Most of these taxes are ad valorem, meaning that they are imposed on the value of the good as opposed to their quantity or volume.

CAPITAL TAXES

In addition to imposing income taxes, provinces also levy capital taxes on a corporation's taxable paid-up capital (share capital plus contributed surplus plus retained earnings plus long-term debt). For example, Ontario has a general capital tax rate of 0.3% for most corporations although a corporation will be exempt from capital tax if its total assets and revenue do not exceed $1 million. The tax applies to both Canadian and non-resident corporations with permanent establishments in Ontario. The tax may be deducted for the purposes of determining income subject to income tax for federal and provincial purposes.

Branch Income

It is possible for a foreign enterprise to do business in Canada without incorporating a company in Canada by operating through a "branch operation". In such case, it would be required to register as an extra-provincial corporation in Ontario and any other province in which it carries

on business. Depending on the nature of the activities undertaken, such registration may be required even if the corporation does not have a permanent establishment for income tax purposes.

A non-resident corporation carrying on business through a non-incorporated branch may also be subject to an additional 15% branch tax imposed by the federal government. This tax is imposed on the portion of the branch's net after-tax Canadian income that is not re-invested in the Canadian business. This tax measure is intended to eliminate the more favorable tax treatment of branches relative to that of subsidiaries by effectively taking the place of the 25% withholding tax which is levied on dividends paid by a Canadian subsidiary to its non-resident parent. The branch tax may be more onerous though in that it is payable in the year in which income is earned regardless of whether the income is in fact distributed to the parent in that year. Withholding tax, on the other hand, is only payable when a dividend is paid, such that the tax can be postponed until actual payment.

Income Determination

The rules regarding the calculation of income for tax purposes are sensibly the same as for individuals and the reader is therefore referred to the portion of this paper dealing with individual taxes.

With respect to inventory valuation, in most cases, either of the following two methods of valuing inventory is available: a) valuation of each item in the inventory at the cost at which it was acquired or its fair market value at the end of the year, whichever is lower; or b) valuation of the entire inventory at its fair market value at the end of the year. Other methods of valuing inventory may be available or required depending on the type of business. For example, property described in the inventory of a business that is an "adventure or concern in the nature of trade" (a concept similar to that of carrying on a business) must be valued at the cost at which the taxpayer acquired the property. Where it is practical to identify costs by reference to specific items, the cost is determined by ascertaining the laid-down cost of the specific items. If it is not practical to determine cost by reference to specific items, it is necessary to use an arbitrary

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cost selection method such as the average cost method or the “first in, first out” (fifo) method. The “last in, first out” method (lifo) and the base stock method are not accepted for income tax purposes as methods of determining cost.

Deductions

Once again, the reader is referred to the section dealing with the taxation of individuals. Two rules of particular concern to foreign companies doing business in Canada are discussed below.

THE “THIN CAPITALIZATION” RULE

Particular consideration should be given to loan transactions between a non-resident parent company and its Canadian subsidiary and to interest charged with respect to such loans. The Tax Act generally disallows the deduction of interest payable by a Canadian subsidiary on debts owed to specified non-resident persons, to the extent that the ratio of such debt to the subsidiary's equity exceeds 2:1. "Specified non-resident" includes any non-resident person who, either alone or together with persons with whom the person does not deal at arm's length, owns shares of the Canadian corporation representing 25% or more of votes that could be cast at an annual meeting of shareholders, or shares having a fair market value of 25% or more of the fair market value of all of the issued and outstanding shares of the corporation.This provision does not apply in computing the income for a taxation year of a corporation whose principal business in Canada throughout the year was the developing or manufacturing of aircraft or aircraft components.

DIVIDEND INCOME

Dividends received by corporate shareholders are included in income but are deducted when calculating taxable income. This deduction prevents tax from being paid many times over on the same amount. Dividends will only be taxed in the hands of the ultimate shareholder who is an individual. However, this treatment is reserved to dividends paid by taxable Canadian corporations or by corporations residing in Canada which are controlled by the corporate

shareholder. A partial deduction will be given in the case of dividends received by a corporation resident in Canada from a foreign affiliate. The deduction in such a case will be equal to the dividend received multiplied by the fraction obtained by dividing the amount of taxable income actually earned in Canada by the foreign affiliate by the amount of income the foreign affiliate would have earned had it resided in Canada.

Tax Incentives

There are two basic tax incentives in respect of business income earned by a corporation: the Small Business Deduction (SBD) and the manufacturing and processing profits deduction. Both of these have the effect of reducing the effective tax rate. A "Canadian-controlled private corporations" (CCPC), defined as a private corporation resident in Canada that is not controlled by one or more non-residents and/or a public corporations, is entitled to both a federal SBD of 16% and a lower rate of Ontario tax, but only on the first $250,000 of active business income. Moreover, any corporation carrying on a manufacturing or processing activity in Canada may be eligible for a tax rate reduction of 7%.

Generous tax incentives also exist to encourage investment in research and development activities. For example, a scientific research and experimental development investment tax credit is available on qualified capital and non-capital expenditures. This credit can reduce tax payable or even result in a tax refund. CCPCs may be eligible for the credit at a rate of 35% on the first $2 million dollars of annual eligible expenditures and 20% thereafter. Other Canadian companies are eligible for a 20% credit. To be eligible, the research and development activities must be carried on in Canada. To claim the credit, the taxpayer will require extensive supporting documentation meticulously showing the various steps, results and conclusions achieved in order to prove that a scientific advancement has taken place.

Withholding Taxes

Canada imposes withholding tax at the rate of 25% (reduced to 15% or 10% by most tax treaties) on various types of "passive" income received by non-residents from Canadian sources. Withholding tax applies to, among others, management or administration fees, interests, dividends, rents and royalties paid by a resident of Canada to a non-resident.

There are certain circumstances where a non-resident may be deemed by the Tax Act to be resident in Canada and thus subject to withholding tax on payments made by it to another non-resident. For example, where the non-resident carries on business principally in Canada, manufactures or processes goods in Canada, or engages in specified resource extraction activities in Canada, the non-resident will be deemed to be a resident of Canada in respect of deductible payments made by it. Further, where a non-resident pays rent to another non-resident for the use in Canada of certain property, the former is deemed to be a resident in Canada for withholding tax purposes in respect of such payments.

The Canadian tax system is a self reporting and self assessing system which imposes the obligation on individuals, corporations and trusts to file an income tax return on all taxable amounts for the preceding fiscal year. Individuals are required to file their tax returns each year by April 30, or by June 15 if the individual received business income. Corporations are required to file their income tax returns within six (6) months of their fiscal year-end.

Income tax applicable to individuals in Ontario is administered federally; therefore a separate provincial income tax return is not required. However, the Province of Ontario administers corporate income taxes and requires a corporation with a permanent establishment in Ontario to file a separate Ontario corporate tax return within six (6) months of the corporation's fiscal year-end.

The Tax Act confers upon the Minister of National Revenue a number of powers such as that to require persons to provide information for the purpose of anything that may be related to the administration or enforcement of the legislation. Typically, the Minister can use special execution measures and enjoys

super-priorities vis-à-vis other creditors of a taxpayer who is in default of the Tax Act. The Minister of National Revenue has a duty to examine a taxpayer's income tax return in order to establish if there is applicable tax, interest or penalties. A notice of assessment is then sent confirming the amount of tax owing or the amount of the tax refund due to the taxpayer. In the absence of fraud or misrepresentation attributable to neglect, carelessness or wilful default, the Minister of National Revenue may not reassess (issue a revised assessment) three years (four years or certain cases) from the day the original notice of assessment was mailed.

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Investment Canada Act

The Investment Canada Act provides that if a non Canadian proposes to establish a business in Canada which is either:

- unrelated to any other business being carried on in Canada by that non Canadian, or
- is a related business but is one which falls within a business activity related to Canada's cultural heritage or national identity that has been prescribed by the Government of Canada,

then a notice of establishment of business must be filed with Industry Canada.

The stated purpose of the Act is to encourage investment in Canada which contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure that such investments benefit Canada.

Notification of the establishment of the business to Industry Canada involves disclosure of information about the non Canadian investor and the business.

If the new business involves an activity relating to Canada's heritage or national identity, the establishment of the business can be made reviewable by the Government of Canada after notice of the new business has been filed. In such an event, the non Canadian will be required to file an application for review with Industry Canada and to demonstrate that the business will be of net benefit to Canada before being allowed to commence business activities.

If a non Canadian wishes to acquire an existing Canadian business by way of a direct or indirect acquisition, the Investment Canada Act requires that either a notice or an application for review be filed depending on the size of the business being acquired and the manner of acquisition. A notice must be filed

in connection with all direct acquisitions of Canadian businesses with assets under $5,000,000 and in respect of most indirect acquisitions with assets under $50,000,000. Indirect acquisitions of Canadian businesses whose assets represent more than 50% of the assets involved in a total international transaction are subject to the $5,000,000 threshold rather than $50,000,000 threshold.

All acquisitions involving assets in excess of the thresholds set out above are reviewable transactions. Advice should be obtained prior to entering into any acquisition transaction so that the specific threshold applicable to that business can be determined.

In the case of reviewable transactions, the non-Canadian is required to file an application for review with Industry Canada and to demonstrate that the acquisition of the Canadian business by that non Canadian will be of net benefit to Canada.

The Investment Canada Act sets out factors to be considered when determining whether net benefit to Canada has been demonstrated. Considerations include the degree of participation by Canadians in the business; the effect of the investment on productivity, technological development and product variety in Canada; competing industries in Canada; the compatibility of the investment with the industrial, economic and cultural policy objectives of the Canadian government; and the impact of the investment on Canada's ability to compete in world markets. This list is by no means exhaustive, and the circumstances of each investment will result in varying weights being attributed to each factor.

The Investment Canada Act also imposes time limits to ensure the prompt review of applications for review and the issuance of decisions. Non compliance with the Investment Canada Act can lead to the imposition of civil and criminal penalties.

Competition Act

All businesses operating in Canada are subject to the provisions of the Competition Act, which is Canada's anti trust legislation. Foreign investors purchasing a Canadian company may be subject to the notification provisions of the Act pertaining to mergers and acquisitions. The Act envisages the categorization of various anti competitive practices into criminal law prohibitions and civil law matters. Included in the criminal law regime are practices such as resale price maintenance, discriminatory and predatory pricing, disproportionate advertising allowances, bid rigging, pyramid and referral selling, and various misleading advertising offenses.

Included in the civil law regime are matters that could potentially impact on competition in the marketplace such as, refusal to deal, consignment selling, exclusive dealing, tied selling and market restrictions, refusal to supply by a foreign supplier, and foreign judgments, laws and directives. It is to be noted that the last of these matters is of particular relevance to a branch operation in Canada. The Competition Tribunal has the power to forbid the implementation by a Canadian company of a foreign court order or foreign law purporting to direct the conduct of a Canadian company or considered by a parent company to be binding upon its Canadian subsidiary, if such implementation will have an adverse effect on Canadian trade and industry. Any directive issued by a parent to a branch or subsidiary can be similarly impugned if its effect on Canadian trade and industry is likely to be adverse.

Amendments to the legislation that came into effect in 1986 and 1987, accelerate the shift to civil law remedies for resolving competition law issues. The most significant changes included the additional provisions regulating mergers and acquisitions. It is now mandatory for those planning mergers exceeding certain size thresholds to file notification of their intention together with specific background information before finalizing the transaction. Other new additions include delivered pricing practices and specialization agreements which will be subject to civil law review and regulation with respect to their impact on competition in the marketplace.

The Director of Investigation and Research is responsible for the administration and enforcement of the Competition Act. The Competition Tribunal, in effect a civil court, is responsible for adjudicating civil law competition matters and issuing appropriate remedial orders. The legislation permits the Tribunal to issue

consent orders agreed to by the Director of Investigation and Research and the parties against whom the order is to be directed. The Director is also authorized to issue advance ruling certificates with respect to proposed mergers stating that he is satisfied that a particular merger will not adversely affect competition and that he will not challenge the merger before the Competition Tribunal.

Trade Legislation

Imports to Canada are subject to the provisions of the Customs Act, Customs Tariff, Special Import Measures Act, Export and Import Permits Act and other legislation, such as the Excise Tax Act.

The Customs Act sets out the administration of the Customs Tariff, which contains the tariff items and duty rates applicable to goods imported into Canada.

The Export and Import Permits Act requires import permits for a range of commodities described in the import control list, which includes many agricultural and textile products. There is also an export control list which requires permits for exports of certain prescribed items from Canada. These include many high technology goods which may be of strategic value.

Canada's anti dumping and countervailing duty laws are contained in the Special Import Measures Act. The Act provides Canadian industries with recourse to anti dumping and countervailing duties in the event they are being materially injured from goods that are dumped into Canada or benefit from subsidies from foreign governments.

The Canada-U.S. Free Trade Agreement (the "FTA") had an enormous impact on Canada's trade laws vis-à-vis the United States. Several industry sectors, including energy, agriculture, transportation and automotive products, have seen a liberalization of rules pertaining to cross-border trade. This trend was continued under the North American Free Trade Agreement ("NAFTA"), which came into force on January 1, 1994.

The key feature of the NAFTA is the elimination of duties and certain other restrictions on substantially all trade in goods among Canada, the U.S. and Mexico. The NAFTA did not affect the phase-out of tariffs which had been agreed upon under the FTA. The phase-out of FTA tariffs was completed on January 1, 1998. As a result of the NAFTA, on January 1, 2003 tariffs on trade between Canada, Mexico, and the United States for all eligible goods were eliminated.

Also, the Canadian, American and Mexican regimes pertaining to dumping, subsidies and related trade disputes are subject to a dispute resolution mechanism under the NAFTA. Where a private party notifies its government that it would like to seek binational panel review of an anti-dumping or countervailing duty order, the government concerned is required to initiate proceedings on its behalf.

Canadian Immigration Requirements for Business People

GENERAL REQUIREMENTS

Canadian immigration law imposes certain requirements on foreign individuals wishing to work in Canada. These requirements are of particular interest to corporations who wish to transfer personnel to their Canadian branch or subsidiary.

Individuals who are to be temporarily employed in Canada must apply through a Canadian government visa office abroad for an Employment Authorization, or at the Canadian border or port of entry if they are citizens of either the U.S. or of Mexico. In order to obtain the authorization, the Canadian employer must usually apply to Human Resources Development Canada (HRDC) for a Confirmation of Offer of Employment, also known as a Job Validation. For the application to be approved, officials at that office must make a determination that the individual's admission to Canada will not adversely affect the employment opportunities of Canadian residents and that there is a lack of suitable Canadian citizens or permanent residents available to fill the position.

Special provisions permit non-Canadians to work in Canada without first obtaining employment validation from HRDC in some exceptional circumstances. The validation requirement may be waived in the case of intra-corporate transfers where an employee of a corporation located outside Canada seeks to enter Canada to work in the corporation's Canadian branch or subsidiary at a senior executive or managerial level for a temporary period. In such cases, the company must prove there is some significant economic benefit such as the creation or maintenance of Canadian jobs.

Where an individual's employment will involve a permanent transfer to Canada, he or she should make application for permanent residence in Canada, perhaps after arriving in Canada on a work permit. Applicants are assessed under a point system which allocates units of assessment based on various selection factors. Generally, an applicant must have 70 units of assessment in order to be successful. The selection factors include intended occupation, experience in the intended occupation, education, age, knowledge of English or French, and personal suitability.

There are special rules for individuals who apply for permanent residence as "self-employed" persons. This category applies to individuals who demonstrate the ability and intent to establish a business that would make a positive contribution to specified economic activities (cultural activities, athletics or farm management) in Canada.

A related category is the "entrepreneur" class. This category is aimed at successful business persons who intend to establish, purchase, or make a substantial investment in a Canadian business. The business, which must be actively managed by the applicant, must be one which will make a significant economic contribution to Canada and must employ at least one Canadian other than the entrepreneur and his or her family members. Conditions imposed on visas granted to entrepreneurs usually require that they buy or start a business within two years of landing in Canada.

Persons admitted to Canada under the above categories may include in their application those members of their immediate families. Immediate family members include the spouse and dependent children - generally those under the

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age of 22 and those 22 and over who have continuously been engaged in full-time studies.

EXPEDITED PROCESSING OF SOFTWARE WORKERS

Since May of 1997, qualified software workers may obtain employment authorizations on an expedited basis by making an application at a Canadian Embassy or Consulate outside Canada. For such cases, there is no need to first obtain a validation from HRDC that the foreign worker will not negatively affect the employment opportunities of Canadians. There is a list of seven (7) software occupations, each having minimum specific education and work experience requirements.

SPOUSES OF FOREIGN WORKERS

On 30 September 1998, the government of Canada announced a special program whereby the spouses of some foreign workers are entitled to work in Canada. In the global hunt for talent, this will provide Canada with a competitive advantage over countries that do not currently allow spouses to work. In order for a spouse to be able to work, the principal spouse must be working in a managerial, technical or highly-skilled occupation and have an employment authorization issued for six (6) months or more. These occupations are listed in a schedule published by the government of Canada.

NORTH AMERICAN FREE TRADE AGREEMENT

The North American Free Trade Agreement ("NAFTA") establishes a special regime for temporary entry of business persons who are citizens of either the U.S. or Mexico. NAFTA, however, does not contemplate changes in the immigration policies of each country regarding the granting of permanent residence status.

Temporary business visitors are classified under the NAFTA into four categories:

- business visitors;
- traders and investors;

- professionals;
- intra-company transferees.

The NAFTA grants temporary entry, without the necessity of an employment authorization, to any U.S. or Mexican citizen who is engaged in trade in goods, the provision of services, or the conduct of investment activities.

<u>Business Visitors</u>: Business visitors are persons who intend to enter Canada for a temporary period of time equalling six (6) months or less for the purpose of performing certain occupational and business functions. These functions include:

- research and design
- production management and purchasing
- sales of goods and services
- after-sale services
- public relations and advertising.

U.S. and Mexican citizens engaged in these occupations and business activities in Canada on a temporary basis no longer need to obtain an employment authorization.

<u>Traders and Investors</u>: The "Traders and Investors" classification covers business persons seeking to:

- carry on substantial trade in goods and services principally between the territory of the Party of which the business person is a citizen and the territory of the Party into which entry is sought; or
- establish, develop, administer or provide advice or key technical services to the operation of an investment to which the business person or the business person's enterprise has committed, or is in the process of committing, a substantial amount of capital,
- in a capacity that is supervisory, executive or involves essential skills.

<u>Professionals:</u> The professions included in this classification extend beyond occupations traditionally recognized as professions to include such occupations as hotel managers, technical publication writers, and management consultants. In some instances, minimum academic or work experience is specified, and the

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professional activity that may be carried out in Canada is sometimes limited. For example, a U.S. or Mexican physician may only be involved in teaching or research in Canada, and not the active practice of clinical medicine.

An employment authorization valid initially for one (1) year will be issued by Canadian immigration officials either at a Canadian consulate or at the point of entry into Canada. The U.S. or Mexican citizen must have documentary evidence of his or her education and professional qualifications as well as documentation verifying the work they will be doing in Canada for a Canadian employer or customer/client.

<u>Intra-company Transferees:</u> As discussed, Canadian immigration policies currently permit the entry of senior executive or managerial staff on an intra-company transfer basis without any employment validation by HRDC. The NAFTA broadens this policy insofar as it applies to managerial and executive personnel who are not top management, to include personnel having specialized knowledge who are not managers of any kind. Work permits can be obtained either at the border (including airports) or at a Canadian Embassy or Consulate ahead of time.

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Classes of Types of Contracts

There are two main types of employment contracts: the individual contract of employment and the collective agreement. The individual contract of employment is between an employer and an individual. It is a result of either a written agreement setting out all the terms of employment or it can stem from oral representations between the parties. The individual contract of employment is often a combination of oral and written terms.

The collective agreement is defined in the Canada Labor Code, R.S.C. 1985, c. L-2 as an agreement in writing entered into between an employer and a union, which acts on behalf of the employees as a bargaining agent, containing provisions respecting terms and conditions of employment and related matters.

Cost of Dismissal and Wrongful Dismissal

The employer may dismiss an employee at any time if it has just cause to do so. However, it must respect the contract of employment and applicable legislation. Sections 57 and 58 of the Ontario Employment Standards Act, 2000, S.O. 2000, c. 41 must be considered when determining notice as it provides for a minimum notice period. For example, if an individual has been an employee for six years or more and fewer than seven years, an employer is required to give at least six weeks of notice before the termination. However, the minimum notice period in the Ontario Employment Standards Act, 2000, S.O. 2000, c. 41 sets out minimal requirements and does not prevent an employee from seeking civil remedy.

Reasonable notice at common law will vary depending on the circumstances of the case. Therefore, when determining whether the employee was given a reasonable notice, courts will usually be more generous because they will consider factors such as the following: (1) availability of similar employment; (2) age of employee; (3) length of service of the employee; (4) experience of the employee in the particular field; (5) qualifications of the employee; (6) remuneration of the employee; (7) responsibility of the employee; (8) performance of the employee; (9) manner of the employee's dismissal; and (10) reasons for dismissal (i.e. misconduct of the employee, etc.). For example, an employee who occupies a high ranked position in a company such as a manager or a specialized position is generally entitled to a longer period of notice than a clerical worker.

The employer also has the option of paying the employee in lieu of notice. The amount is determined by calculating what the employee would have been paid during the notice period. One should note that the employee has a duty to take reasonable steps in order to find alternate employment in all wrongful dismissal situations.

Special Regime for Employment Contracts for Directors

In Ontario, section 1(3) of the Labor Relations Act, S.O. 1995, c. 1 Sched. A clearly states that persons exercising managerial functions are not subject to the Act. Although directors and other persons in managerial positions usually negotiate a contract for employment that may include extensive compensation packages, there is no "special regime" for employment contracts for directors. Furthermore, directors are not subject to the Ontario Employment Standards Act, 2000, S.O. 2000, c. 41.

Employees' Representatives and Union Representation

Historically, trade unions emerged out of unacceptable employment practices. They have been the response to the unequivocal position between the employer and its employees. As a result, unions have enabled workers across the country to establish acceptable work conditions and employment contracts that better reflect the values and the needs of employees. In a unionized context, the individual contract of employment has been replaced by the collective agreement.

In Ontario, the Labor Relations Act, S.O. 1995, c. 1 Sched. A defines a trade union as "an organization of employees formed for purposes that include the regulation of relations between employees and employers and includes a provincial, national, or international trade union, a certified council of trade unions and a designated or certified employee bargaining agency."

In order for a union to represent its members' interests, it must be certified pursuant to the Ontario Labor Relations Act, S.O. 1995, c. 1 Sched. A. The certification process has several steps which include: (1) Delivery of Application for Certification by the union; (2) Service of Application for Certification on the employer and filing the aforementioned document with proof of service and membership evidence at the Ontario Labor Relations Board; (3) Delivery of Response to Application for Certification by employer; (4) Service of Response to Application for Certification on the union and filing the aforementioned document with proof of service at the Ontario Labor Relations Board within two business days; (5) Selection of date for the certification vote by the Ontario Labor Relations Board; (6) Vote; and (7) Delivery of a copy of the vote decision to the employer and the union by the Ontario Relations Board.

Therefore, a union will be certified for representation if a majority of the employees vote for union representation.

Once certification is complete, the employer will be forced to deal with the union who is the representative of the employees. Therefore, the union has the responsibility of looking after the employees' interests.

Collective Agreements

Although the terms in a collective agreement may vary depending on the parties, there are no classes or types of collective agreements. The collective agreement is a binding contract that has been negotiated between a union, on behalf of its members (i.e. the employees), and an employer that sets out the obligations of each party.

Wages

In Ontario, employees may be paid on an hourly rate, a fixed salary, a fluctuating salary, commission, or piecework rate basis.

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The minimum wage is governed by the Employment Standards Act, 2000, S.O. 2000, c. 41, which has established the general minimum wage in Ontario for 2005 at $7.45 per hour. However, there are other minimum wages that apply to certain individuals such as students under 18 years of age, an employee who serves liquor as part of his or her regular work, a hunting or fishing guide and an employee who is a homeworker.

Employers must pay their employees overtime pay of at least one and one half times their regular rate for each overtime hour worked in excess of 44 hours each week. If the employee and the employer agree to do so, it is possible to set a different weekly threshold in which case the number of hours worked exceeding the threshold are overtime hours and must be paid accordingly. For example, if an employee agrees to work a certain amount of hours that will be averaged over a number of weeks and if the employer obtains the approval of this agreement from the Director of Employment Standards, this new threshold will be set for the duration set out in the agreement or in the approval from the Director.

Employment Regulations

In Ontario, the applicable regulations in the context of employment and labor law are the regulations under the Employment Standards Act, 2000, S.O. 2000, c. 41 and the Ontario Labor Relations Act, S.O. 1995, c. 1 Sched. A. At the federal level, the applicable regulations are under the Canada Labor Code, R.S. 1985, c. L-2.

Social Security

The Canada Pension Plan (hereinafter "CPP") is an earning-related insurance plan. Every Canadian over the age of 18 who earns a salary must contribute to the CPP unless they fall into one of the exceptions. There are three types of CPP payments: (1) disability benefits; (2) retirement pension; and (3) survivor benefits.

Employment Insurance (hereinafter "EI") is a system that was established to provide temporary financial assistance to unemployed Canadians while they search for new employment or while they enhance their skills.

The employer's maximum CPP contribution for 2005 is set at 4.95% of contributory wages and salaries.

The employer's EI rate for 2005 is set at $2.73 per $100 of insurable earnings with a maximum insurable earning of $39,000.

The amount that an employee will contribute to his or her CPP varies depending on their salary. The maximum pensionable earnings for 2005 is set at $41,100 and there is a minimum level, which has been frozen to $3,500. The maximum contribution for an employee in 2005 is set at a rate of 4.95% of contributory wages and salaries. The employee's maximum contribution to the plan in 2005 is set at $1,861.20. Self-employed workers must also contribute to their CPP. The maximum contribution for 2005 is set at a rate of 9.9% of contributory self-employed earnings.

The employee contribution rate for 2005 is at $1.95 per $100 of insurable earnings with a maximum insurable earning of $39,000.

Although the rate of pay is higher when an employee works overtime, EI still applies. In fact, every hour of overtime worked is the equivalent of one hour of insurable employment.

Health and Safety

In Ontario, Health and Safety in the workplace is regulated under the Occupational Health and Safety Act, R.S.O. 1990, c. O.1 and the Regulations under the statute and the Ontario Workplace Safety and Insurance Act, 1997, S.O. 1997, c. 16 Sched. A. Employers have a general duty to take every precaution reasonable in the circumstances for the protection of their workers. Employers have a duty to provide a safe work environment. Employers must educate and train workers in their workplace and may have a duty to provide workers with written instructions in certain circumstances. Employers must have a written occupational health and safety policy, which must be reviewed annually and be posted in the workplace in a conspicuous location. Employers must also assist health and safety representatives and establish an occupational health service.

Employers must post a copy of the statute and materials explaining the statute in a conspicuous location in the workplace in English and the majority language of the workplace. Employers have a duty to appoint competent supervision and a duty to employ workers of legal age, which varies from 14 to18 depending on the industry. Lastly, employers have a duty to keep records of biological, chemical and physical agents in the workplace and the handling, storage, use and disposal of these agents.

Contracting and Outsourcing

A person may enter into a contract that is one for service or for the provision of services. A contract that is one for service establishes an employment relationship between the parties. A contract that is for the provision of services does not establish an employment relationship and a person in that situation is considered an independent contractor. In order to determine whether a person is an employee or an independent contractor, the court will evaluate the parties' relationship by considering a number of factors such as: (1) the degree or absence of control, exercised by the alleged employer; (2) the ownership of the tools; (3) the chance of profit or loss; and (4) the integration of the alleged employee's work into the alleged employer's business. For example, a person is an employee if the employer exercises a certain degree of control such as determining his work hours, if the employer owns the tools with which the employee accomplishes his work, if the employee has no chance of profit or loss and if the employee's work is an integral part of the employer's business such as a window installer for a windows and doors business.

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Types of Ownership

There are two usual forms of concurrent ownership: joint tenancy and tenancy in common. To create a joint tenancy four unities must be established which together describe the need for near perfect equality between or among the joint tenants. Each joint tenant must be equal in nature, extent and duration (unity of interest); they must arise from the same instrument or act (unity of title); their interests must arise at the same time (unity of time); and their rights must relate to the same piece of property (unity of possession). The underlying notion is that there is only one tenant rather than joint tenants holding distinct shares. The most important trait of a joint tenancy is the right of survivorship, the jus accrescendi. Essentially, once a joint tenant dies, his or her interest extinguishes and the holdings of the survivor tenant increases. Survivorship occurs automatically, as an operation of law and therefore is an alternative to a transfer by last will and testament.

For tenancy in common, unity of possession must exist; however, all four unities may not be present. As there is not always a unity of interest, each party may possess an unequal quantum of the title-for example, one-third belongs to A and two-thirds belong to B. Unity of possession nevertheless remains intact as the individual shares remain undivided during the length of the relationship. There is no right to survivorship under the tenancy in common and therefore the interest held under this type of ownership devolves on the death of a tenant, by will or according to the law of intestacy.

Once the four unities are present, whether ownership is joint tenancy or tenancy in common will depend on the intention of the grantor. When there is no reference to either form, a rule of construction deemed that a property conveyed simply as “to A and B” would create a joint tenancy if there is no intention to create a tenancy in common. However courts have held that even a slightest intention to create a tenancy in common will rebut this rule of construction. The court will determine whether there are any words of severance such as "equally amongst them" "respectively" or "between" which would indicate an intention to create a tenancy in common as they signify distinct shares of the property. In some jurisdictions, such as in Ontario, the presumption has been reversed via statutory reforms and therefore the relevant statute should be considered.

Land Registration System in Ontario

Land registration systems provide a uniform method of tracking instruments creating or disposing of interests in land and other instruments that affect the use of land. There are two such land registry systems: the registry system, governed by the Registry Act, and the land titles system, governed by the Land Titles Act. The key difference between the two is that the registry system produces an inventory of instruments affecting title, whereas the land titles system produces a statement of title. The registry system is more prominent in Southern Ontario whereas the land titles system is more common in Northern Ontario. Efforts to simplify the registration of documents and title-searching have culminated in the Land Registration Reform Act ("LRRA") which is an effort to harmonize the two systems, develop an automated title record system, develop a property mapping system and provide for the electronic registration of documents. The LRRA does not substitute either the Registry Act or the Land Titles Act, but acts as an overlay.

Leasehold Types

A lease has been defined as a demise of land that confers exclusive occupation by a landlord to a tenant. The relationship that results is a tenurial one. There are five types of leases: (1) fixed term; (2) periodic tenancy; (3) tenancy at will; (4) tenancy at sufferance; (5) perpetual lease. A fixed term lease is a lease that is for a specific duration with a particular commencement and termination date. A lease "for life" therefore does not fall into this category as it creates a life estate. A periodic tenancy is a lease that is to be enjoyed for some recurring unit of time and is terminated by notice. For example, a month by month lease. Generally the amount of notice is equivalent to the length of the tenancy period unless it is a yearly tenancy, in which case a six-month notice is required according to common law although statutory requirements may be different

depending on the province. A tenancy at will does not have a set period or term and continues only as long as the tenant and landlord wish with either party having the power to terminate the tenancy. When a tenant remains in possession of the premises even though the lease has expired, the law may imply that it is a tenancy at will. However, in other cases it may create a tenancy at sufferance, which is a questionable type of lease as it is non-consensual and therefore does not create a tenurial relationship. Perpetual leases, which have no fixed term and no right of termination on notice and can last forever, are sometimes still found in the law such as when the Crown grants land in this form rather than as a fee simple estate.

Lease Formalities

There are several characteristics that should be contained in every lease to make it a valid contract. It should denote exclusive possession, identify the parties, the property, the term, the date of commencement and whether any rent must be paid. At common law there are not any strict formal requirements for leases, however, the Statute of Frauds does require that leases must be in writing and signed by the lessor, not the agent, otherwise a tenancy at will is created if the tenant possesses the premises with the consent of the landlord. The requirement of some form of written documentation does not apply if the lease is for less than three years and, in Ontario, the rent amounts to at least two-thirds of the rental value. In some Canadian provinces, a prescribed form is used. Due to the unfairness that results from formal requirements, there are several principles in common law that counter the effect of non-compliance. For example, if a tenant possesses the premises under a void lease but pays the rent and the landlord accepts that payment, a periodic tenancy is presumed to be created at common law. In other circumstances, equity may also intervene to enforce a verbal agreement for a lease if there is partial performance that validates the existence of an agreement.

Mortgages and Other Security Interests

A mortgage is an important security interest in property that is conferred by the mortgagor on the mortgagee and provides the mortgagee with security if the repayment obligations are not complied with. Generally the legal title to the

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property will be conveyed to the mortgagee as security and the mortgagor will have a contractual right to redeem the mortgaged property or interest. However, in Ontario, legislation has reversed this system and provides that the charge is viewed as an encumbrance on the legal estate of the charger. Generally, the mortgaged property will be a freehold estate, but can also be a leasehold or other interest such as an easement. Most standard loan transactions in Ontario are conducted with respect to a commitment which contains the standard terms and conditions of the contractual relationship such as the principal amount of the loan, the interest rate, the monthly payments, the period over which the loan is amortized and the maturity date of the charge at which time the amount outstanding must be repaid. Amortization refers to the time that is required to discharge the debt (including interest) if the blended payments are allowed to run their full course.

Enforcement of Mortgage Security

There are a number of remedies for a mortgagee that is faced with a defaulting mortgagor. The mortgagee may sell the property with a private power of sale if it is expressly provided for in the provisions of the mortgage or via the Mortgages Act or pursuant to a court order. A power of sale enables a mortgagee to convey the mortgaged property to a purchaser free of the interest of the mortgagor or any other person who has an interest in the property but ranks after the mortgagee in terms of priority. A judicial sale has essentially the same effect. The mortgagee may also obtain title to the mortgaged property by accepting a quit claim deed or a foreclosure action. Following the foreclosure action, the mortgagee becomes the owner of the property and other persons with an interest in the mortgaged property that are below the mortgagee in terms of priority will lose their interest in the property. The mortgagee may otherwise opt to take possession of the mortgaged property or obtain a judgment against the mortgagor.

Other Types of Security Arrangements

Although the mortgage agreement is the most common form of security arrangement, there are also pledges and liens. Pledges are loans secured by the lender actually taking possession of a particular object, for example, when an

object is left with a pawnbroker. Liens are another common type of security that is a right in the property which remains attached to an object that has been purchased without being entirely paid for. In some cases, it will involve possession of the object until the complete funds have been provided or it may be registered against the property. Liens can be “particular” in that they relate to the specific goods or they can be “general” in that they can be imposed over the debtor's other property and will arise under contract, statute or trade usage. Ultimately, the lien may be enforced by a court order to sell the property and the proceeds will be used to pay off the debt.

Transfer Formalities in Ontario

It is important to go over the agreement of purchase and sale, title searches, letter responses, requisition letter and note the various matters or problems that must be attended to and the documentation that must be prepared prior to closing a real estate transaction. Generally one will want to confirm the basic terms of the mortgage and the purchaser will want to obtain a mortgage statement or the vendor will want to obtain a discharge of a mortgage that will not be assumed by the purchaser. If you are the vendor's solicitor, you should also obtain a title report in order to determine whether there are any difficulties with the title that may effect the closing. The vendor must also supply the purchaser with a copy of the Transfer/Deed of Land for the property that will be needed so his or her solicitor can prepare the Transfer/Deed of Land. The vendor should also supply his or her solicitor with a survey for the property, the tax bill, and utility accounts and the vendor has an obligation to have the utility meters read on closing. The vendor is therefore usually responsible for the following documents: The Transfer/Deed of Land which transfers ownership to the purchaser; a Statement of Adjustments which is basically a balance sheet that lists all of the adjustments to the purchase price such as utilities, realty taxes etc.; a Direction Regarding Funds authorizing the purchaser to make direct payment to parties other than the vendor; a Declaration of Possession with regards to the use and occupation of the premises while the vendor is still the owner; an Income Tax Affidavit with respect to the vendor's residency status; a Bill of Sale if movable property is also being transferred to the purchaser; an Insulation Warranty to insure that there is no urea formaldehyde foam insulation in the structure; an Affidavit Regarding Executions to determine whether there are any executions against the owners of the property and the current vendor; Documentation Relating to Leases with regards to whether or not they will be assigned; and any undertakings. A purchaser's solicitor must ensure that the answers to requisitions are satisfactory and how purchasers wish to take title (for example, as tenants in common or joint tenants). Documents commonly required by the purchaser are as follows: Direction Regarding Title; Land Transfer Tax Affidavit for the land transfer tax owing; and any Vendor Take Back Mortgage which is a mortgage to be given to the vendor as part of the closing proceeds. Moreover, Goods and Services Tax ramifications should also be considered.

On the day of closing, the purchaser's solicitor should personally attend at the Registry Office or the Land Titles Office to do a subsearch of title from the last instrument shown on the initial search to ensure there have not been any further registrations on the property. The purchaser's solicitor will also have to obtain an execution certificate against the vendor. The vendor's solicitor will also obtain an execution certificate if the purchaser is giving back a mortgage to the vendor. The closing process requires an exchange of documents, keys and cheques. Once the documents are exchanged, the purchaser's solicitor will go to the registration desk and the vendor holds the cheques in escrow until the closing is completed. The registration costs and land transfer tax will be paid at the time of registration.

In Ontario, there is also the possibility of using E-reg, which is an electronic system wherein documents are created, submitted and maintained electronically and is only available for those properties that are registered under the Land Titles Act. The basics of a real estate closing have not changed with this system, only the way certain steps are carried out has been altered due to logistical concerns.

Restrictions on Acquisition: Residency of the Parties

Non-residents are generally not restricted from purchasing real property in Canada. However, special consideration should be made if a vendor is a non-resident of Canada. If a vendor is a non-resident then section 116 of the Income Tax Act will be applicable and the vendor must obtain the appropriate certificate

from Revenue Canada, or else the purchaser is entitled to hold back the appropriate portion of the purchase price and remit it directly to Revenue Canada. A clause establishing that the vendor is a Canadian resident should be in the Agreement of Purchase and Sale and a declaration should be obtained by the vendor confirming compliance with section 116. Section 116 places the onus on a purchaser to reasonably inquire as to whether the vendor is a Canadian resident because otherwise the purchaser will be liable to pay partial capital gains taxes on behalf of the vendor.

Zoning and Permits

All construction, development and use, including subdivision planning must comply with the zoning by-laws and official city plans of each municipality as well as the Ontario Planning Act. It is important to first determine the current zoning of the land in question. Zoning by-laws are a method the municipality uses to control the use and type of development of the lands within its borders. The zoning by-laws will set out specific requirements that must be followed such as building heights, the number of parking spaces, the size of the back yard, etc.

Moreover, amending the zoning by-laws require circulation and notice provisions in the Planning Act though minor variances to the zoning by-laws may be adjusted by committees depending on the municipality. For example, in the City of Ottawa, it is the Committee of Adjustments.

Building permits are also required before a new building or structure is constructed, demolished, or altered and to change the use of an existing building. All construction in Ontario must comply with the Ontario Building Code Act which requires homeowners to obtain building permits prior to construction in order to ensure compliance with basic Building Code standards and other municipal requirements.

The Planning Act must be given specific consideration as section 50 affects almost all real estate transactions within Ontario. Section 50 refers to subdivision control and contains a number of specific rules. Section 50 contains the basic prohibition which states that a person cannot enter into certain transactions (including a sale, transfer or mortgage) unless that person does not retain an interest (such as ownership) in the abutting lands. This basic prohibition can be circumvented if it falls into one of the enumerated exceptions. It applies to all developments in Ontario and must be complied with as non-compliance is fatal in that no interest in the land will pass.

Special Legal Protections for Parties in Ontario

New home agreements for purchase and sale are often conducted on a builder's form that is drafted to protect builders and often allow the builder to vary from the agreed basics. The Ontario New Home Warranties Plan Act led to the creation of the Ontario New Home Warranty Program in an effort to impose restrictions on unilateral extensions to the closing date by the vendors or purchasers and imposes notice periods, limitations on the substitutions of materials, and disclosure obligations. Also, the Plan allows a purchaser to have recourse to an insurance fund if there are problems with the building which the builder cannot or will not rectify. It is the responsibility of the purchaser's solicitor to ensure that both the vendor and the builder are registered with the Ontario New Home Warranty Plan.