Doing Business in Canada: A Guide for U.S. Tech Companies

A great place to live & do business

Why expand into Canada?

It's one of the best places in the world to live, work, and invest. In fact, Canada was ranked the No. 1 country in the world according to the 2021 Best Countries Report by *U.S. News & World Report*. Quality of life, social purpose, and a good job market give Canada its high ranking. Not only is it a great place to live, but its highly educated and skilled workforce, access to large markets, and strong support for innovation in a range of technology sectors make it a compelling place to do business for U.S. technology companies.

Canada is already attracting the world's biggest names in tech. Google, Amazon, Facebook, Twitter, and Salesforce–to name a few–all call Canadian locations home. Canada's tech hubs aren't just emerging, they're established and world-renowned. Toronto, Vancouver, Ottawa, and Montreal all rank in CRBE's top 20 tech talent markets in North America, with Toronto in the No. 4 spot.

Meanwhile, the COVID-19 pandemic showed us all the vital role that tech plays in our lives, and it emerged as a resilient sector. As economies around the world recover from the long-lasting ramifications of the pandemic, Canada remains a desirable expansion target. Its economy is rebounding; according to Statistics Canada, the July 2021 unemployment rate was 7.5% just 1.3% higher than pre-pandemic levels.

Despite Canada being an exciting investment opportunity for tech companies and start-ups, choosing to expand into a new country has its challenges. To successfully capitalize on the opportunities available you need a clear, proactive action plan. In this guide we outline what you need to know about expanding your tech business into Canada and how BDO's cross-functional teams can help you achieve your goals, including:

1. Creating the right strategy for expansion
2. Hiring top tech talent
3. Choosing your location
4. Getting support for tech innovation
5. Raising capital for rapid growth
6. Ongoing regulatory compliance

Economic snapshot

GDP
$1.97 trillion

Population
38 million

14 Trade agreements with **51** countries

18.6%
Increase in Foreign Direct Investment (2019)

$94 billion
ICT sector's contribution to Canada's GDP (2019)

over 2.8 million
STEM graduates

(Sources: Statistics Canada, Invest in Canada)

1. Creating the right strategy for expansion

Don't leave money on the table.

Expanding into a new country is a complex process that must be done strategically in order to minimize risk, limit potential tax liabilities, and maximize profits. Choosing the right strategy and business structure for starting a business in Canada is one of the most consequential decisions a business leader will make.

The structure you choose needs to take into consideration tax outcomes, the opportunity for government incentives, as well as ensure your business needs are met–now and into the future. See below a high-level overview of common ways U.S. companies can enter the Canadian market and the benefits of each.

Branch

- Allows you to operate without a separate legal entity
- Parent foreign company responsible for liabilities of the branch operations
- Could be subject to branch tax of 25% on profits not reinvested in Canada in addition to corporate tax

Subsidiary

Canadian Corporation:

- Generally protects the U.S. parent company from Canadian taxation if properly structured and maintained
- Monitor recent U.S. tax rules that could lead to U.S. taxation on non-U.S. earnings
- U.S. parent will be subject to U.S. taxation when the Canadian subsidiary declares and pays a dividend
- The Canadian subsidiary will be required to withhold dividend withholding tax and the 25% domestic tax rate could be reduced under an applicable tax treaty

Unlimited Liability Corporation:

- U.S. parent entities, particularly those that are flow-through entities for U.S. tax purposes, may seek to set up operations in Canada through an unlimited liability company
- Canadian income or loss will flow through to the U.S. owners. The goal is to eliminate double taxation that occurs in a corporate tax model

Merger & Acquisition

- Acquiring a Canadian business as a way of entering the marketplace
- It's important to complete proper due diligence and ensure efficient structuring is done that is the right fit for your business

Sub-contracting

- Foreign entities can easily enter the Canadian market by sending non-resident employees or by sub-contracting work with existing Canadian companies
- Ability to transition to a more formal branch down the road

Additional tax considerations for your expansion strategy:

Financing Canadian operations:
When it comes to financing, often companies choose to finance with equity or a combination of debt and equity. However, when this type of financing is between a Canadian corporation and a specified non-resident shareholder, thin capitalization rules apply.

A thinly capitalized entity refers to when the level of an entity's debt is much greater than its equity. The Canadian thin capitalization rules limit the deduction of interest on loans advanced by non-resident shareholders of Canadian companies together with certain non-arm's length persons. Under the current rules, the maximum amount of cross-border debt is limited to 1.5 times equity. If the thin capitalization rules are applicable, interest deducted in excess of the 1.5:1 debt-to-equity proportion is disallowed. The disallowed portion is deemed to be a dividend and subject to withholding tax.

The Federal Budget 2021 proposed additional rules that will limit interest deductibility when foreign entities are financing their Canadian operations–in addition to the current thin cap regime. As of the date of this publication, no additional information has been released on these proposed rules.

Transfer pricing:
Transfer pricing occurs when goods or services are bought and sold between the foreign entity and the Canadian entity within the same group of companies. These transactions must be priced properly to ensure the appropriate amount of profit is reported in Canada. The Canada Revenue Agency (CRA) is known to heavily monitor these transactions, and penalties can be severe. Any business operating in another jurisdiction can run afoul of tax laws governing transfer pricing without proper care and planning.

Canada-U.S. tax treaty:
U.S. companies may be exempt from Canadian income taxation if their activities are protected under the treaty. The treaty prevents double taxation and decides which country has taxing rights. The treaty does not exempt sales tax.

While achieving an optimal tax result should be a key factor when considering your foreign expansion options, business strategy should always come first. Ensure that your tax strategy supports your business strategy, not the other way around.

There's no one-size fits all solution:
BDO can help you understand the different structures and ownership models for carrying on business in Canada and the tax implications of each. Our team of experts will review your strategy, learn what your goals are, and model out different options that best suit your business needs. As your operations evolve in Canada, our team will continue to work with you and ensure you are operating within the structure outlined.

2. Hiring top tech talent

Now that you've chosen a corporate structure, it's time to consider the team that will be running your Canadian operations. Employees are crucial to your success, and hiring top talent is key. One of the biggest advantages of investing in Canada is the highly diverse, skilled, and educated workforce–as well as the relative ease of access to global talent. However, competition for this talent is fierce, so you'll need to establish competitive compensation packages to attract the right people.

What to consider when establishing your workforce in Canada:

Carrying on business in Canada - The threshold for carrying on business in Canada is low. For example, a non-resident employee attending a trade show in Canada could trigger a tax filing requirement.

Work permits - Ensure that your people are coming into Canada with the proper permits, either temporary work permits or permanent residency permits. You will need to understand what the employee's role is and how long they will be in Canada in order to apply for the proper permit.

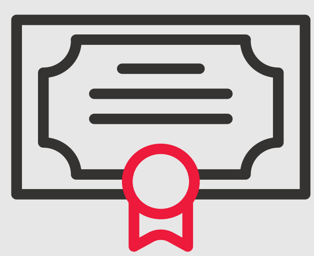
Payroll structure - Setting up your payroll structure properly from the onset is imperative. Some U.S. companies often don't realize how comprehensive Canadian payroll rules are. You will be subject to payroll regulations for an employee starting on day one of the employee working in Canada. This may include:

- **Deductions & withholdings** - Employers (whether resident or non-resident) are generally required to withhold from the employee's pay the various payroll taxes, including federal and provincial income tax, Canada Pension Plan contributions, and Employment Insurance contributions.
- **Equity compensation** - Employers must also take note of special rules applicable to equity compensation packages. For example, as of July 1, 2021, Canada introduced a $200,000 limit on stock option deductions if certain conditions are met. (Read more about Canada's employee stock option rules here.)
- **Employee business travel** - Tracking your employees' business travel is critical to tax compliance. How much time employees spend in their home and host country have implications for corporate tax as well as for the employees' personal tax, specifically their tax residency and scope of taxation.

While it may be tempting to overlook an employee that will only be in Canada briefly, penalties and interest may apply and compound over time. It is crucial that you remain compliant to keep a good standing with the Canadian tax authorities and avoid any unnecessary consequences.

59%

of the Canadian workforce has a post-secondary education, making Canada the most educated population in the world.[1]



Tapping into global talent

Despite the deep pool of talent in Canada, it can still be a challenge for companies to find the right people. This is why Canada created the Global Skills Strategy, making it easier for companies to bring global talent to Canada. Eligible foreign workers can move quickly through the immigration system and receive work permits within two weeks. According to Invest in Canada, the successful program has brought more than 30,000 skilled workers to Canada since 2017.

BDO's experts have the tools and knowledge to navigate the tax compliance issues that arise from starting a remote workforce. Our team can assist with everything from setting up the proper payroll structure, to cost management planning, to analyzing wages and benefits in each jurisdiction.

Remote work is here to stay

The impacts of COVID-19 on traditional workforce norms are likely to be felt long after the pandemic. A Benefits Canada survey found that 80% of people expect to work away from the office at least three times per week, even when the pandemic subsides. This is even more true for agile and nimble tech companies; for example, companies like Shopify are making a more permanent shift to work-from-home culture.

If employers want to cultivate a future-forward workplace, they must be willing to support remote workers. Adopting flexible work policies that allow employees to work-from-home will increase worker satisfaction, provide access to new talent, and accelerate entrance to new markets.

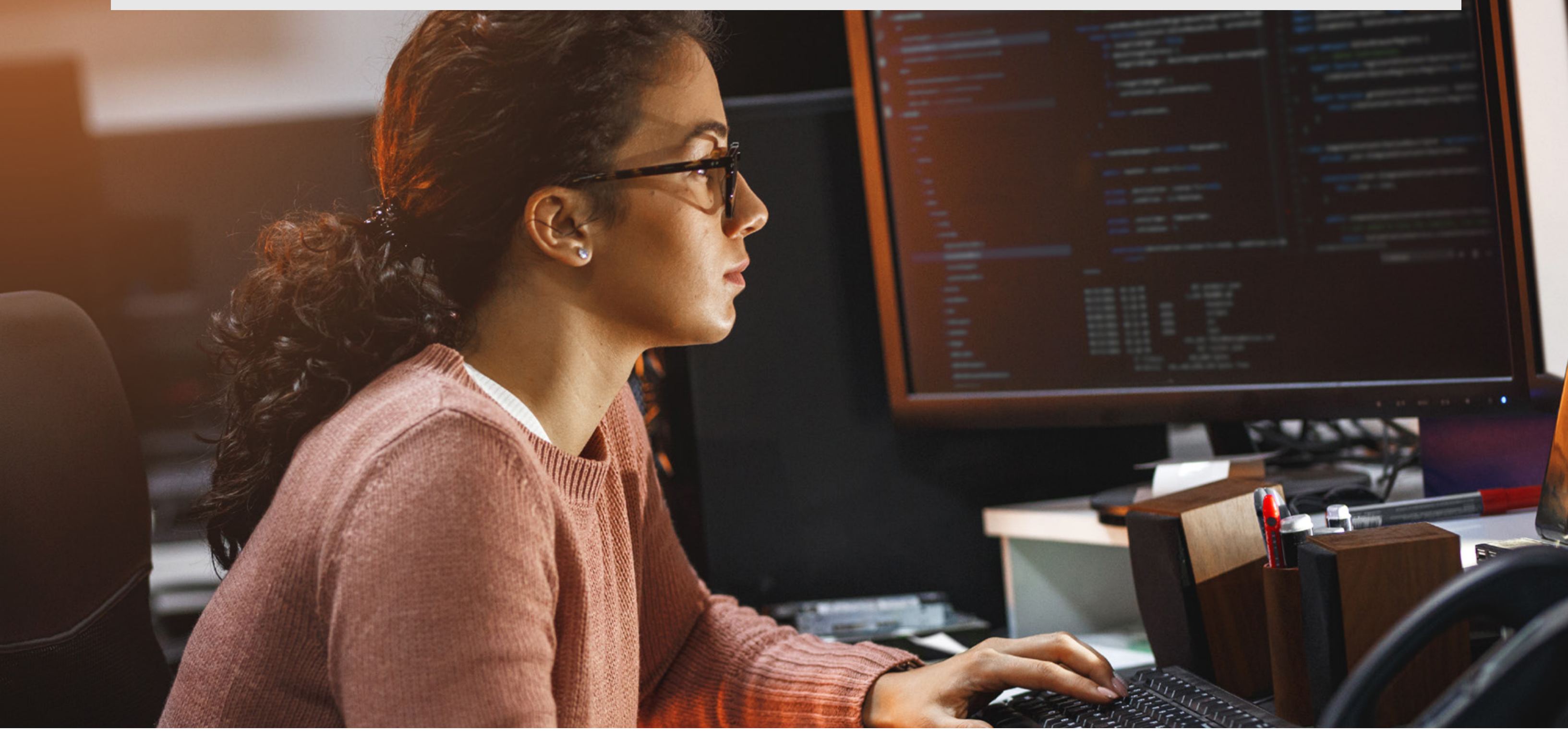
Because of where your employees physically work, payroll obligations will arise, and compliance of these obligations will be key to ensure smooth sailing into new territory.

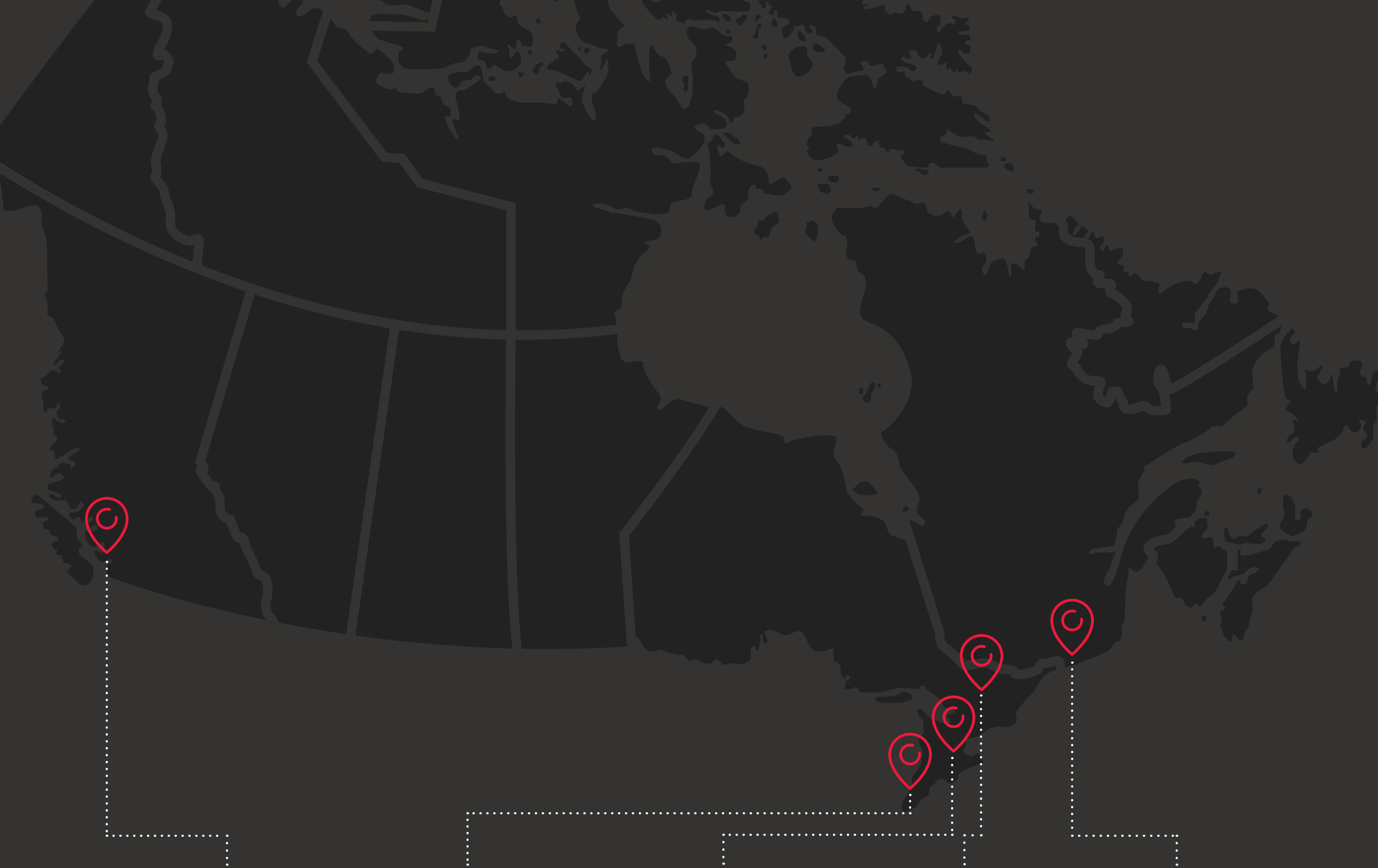
3. Choosing your location

Location, location, location. Canada boasts several world-renowned tech innovation hubs as a result of deliberate government efforts to support innovation. These hubs aren't just in Canada's largest cities, they're in smaller markets where support for different industries is being nurtured. For example, Quebec tax breaks for video game developers have made Montreal a global innovation hub for this sector.

Choosing a strategic location for your operations is yet another critical decision you will need to make for your company. Tech companies should take into consideration the city or region best suited to support its niche. Post-secondary institutions, innovation hubs, access to customers, regional taxes, and proximity to your U.S. operations need to be evaluated. Read more about Canada's top tech innovation hubs on the next page.

Among the top 10 "most tech" markets in North America by labour concentration, 6 are Canadian.[2]





Vancouver	Waterloo Region	Toronto	Ottawa	Montreal
84,900 tech workers	**22,400** tech workers	**250,000** tech workers	**76,200** tech workers	**141,000** tech workers
▶ Known for cleantech knowledge base ▶ British Columbia's subsidies have helped create a Hollywood North hub	▶ Home to the first-ever smartphone ▶ Known for cybersecurity, machine learning, autonomous vehicles, and robotics	▶ 4th largest tech hub in North America ▶ World's highest concentration of AI start-ups	▶ Tech jobs make up 11.6% of total jobs here, the highest concentration in North America ▶ Known for automotive and autonomous vehicle expertise	▶ Quebec offers corporations carrying out certain IT activities an e-business tax credit equal to 30% of eligible salaries ▶ Many well-known multinational computing and social-networking companies have AI labs here

(Source: CBRE 2021 Scoring Tech Talent Report)

4. Getting support for tech innovation

Canada was the 1st in the world to develop AI strategy, investing $125M for a Pan-Canadian Artificial Intelligence Strategy.[3]

A major factor for Canada becoming a tech innovation hub is its significant investments in R&D. Canada recognizes the important role innovation and technology play in driving the economy forward and improving lives. The tax benefits for Scientific Research and Economic Development (SR&ED) activities are amongst the most generous in the world. Canada encourages both Canadian businesses to invest resources into SR&ED and foreign businesses to perform their SR&ED in Canada.

There are numerous tax credits and funds available to help companies like yours expand, develop new technology, and hire and train staff–both provincially and federally. Below are a few of the most noteworthy incentive programs in Canada:

SR&ED:

- Provides income tax credits and refunds for expenditures on eligible R&D activity in Canada
- Businesses can claim a non-refundable tax credit equal to **15%** of eligible expenditures
- Canadian Controlled Private Corporations (CCPCs) can earn up to **35%** in refundable tax credits for eligible expenditures
- Provides more than **$3 billion** in tax incentives to over 20,000 claimants annually[4]

Strategic Innovation Fund:

- Supports business activities such as R&D projects, firm expansion, attraction of large-scale investments to Canada, and collaborative technology demonstration projects
- Launched in 2017, the fund to date has announced **96** projects totaling **$4.9 billion** in contributions[5]

Supercluster Initiative:

- Designed to connect businesses, academic institutions, and not-for-profit organizations to speed up growth in some of Canada's most promising industries
- Five superclusters focus on areas of **ocean sciences, artificial intelligence, advanced manufacturing, protein industry, and digital technology**
- Matched dollar-for-dollar by the private sector, these superclusters will infuse nearly **$2 billion** in the economy and grow Canada's GDP by **$50 billion** over the next 10 years[6]

We're here to help you navigate provincial and federal government incentives and tax credits designed to support your growth.

5. Raising capital for rapid growth

Capital is the lifeblood of a high-growth tech company. Most companies will require funding to support product development and the development of the business—everything from patents to marketing. Yet fundraising can be one of the most challenging tasks for founders to perform.

Evaluate capital options

The first step in financing your operations is to determine the amount of capital you will need. Once you know how much you'll need to set up and maintain your business, you should evaluate financing options. There's dilutive capital, where you give up equity, or there's non-dilutive, where you don't. Taking a blended approach is ideal. If you're in scale-up mode and considering substantial capital, private equity firms, commercial banks, alternative lenders, and government tax credits like SR&ED can be part of that mix.

Work with BDO to determine the optimal capital structure that aligns with your objectives. Leveraging close relationships with lenders, we can facilitate valuations, due diligence, and negotiations.

6. Ongoing regulatory compliance

Accounting & financial reporting requirements

While you are focused on finding talent, choosing a location, and setting up operations, financial reporting requirements may be neglected. Creating an accounting framework that supports your business needs and lifecycle is vital to your overall plan. As financial statements are used by investors, buyers, and lenders, the right accounting framework isn't just a compliance issue—it can help your company get to the next level.

U.S. GAAP and Canadian GAAP (Generally Accepted Accounting Principles) are very different frameworks. There are significant differences in how revenue is reported, and this needs to be taken into consideration when doing consolidated reporting. (See BDO's summary of Canadian accounting standards.) For example, some banks and lending institutions require covenants to be provided for entities both on a stand-alone and a consolidated basis, such as net working capital or EBITDA (earnings before interest, taxes, depreciation, and amortization). There could be large differences in how these financial covenants and performance measures are reported depending on the framework that is used. It's important to have conversations with your lenders and stakeholders to identify these differences and agree on the format of the reporting for these measures in advance.

The volume and pace of change for reporting standards–paired with the lean finance departments of today–requires external support, knowledge, and experience. You'll likely need professionals in Canada who provide first-class accounting advice. BDO's Accounting Advisory team can guide you through your compliance obligations, as well as add value by:

- Setting up the proper accounts,
- building reporting packages for your U.S. company, and
- converting Canadian GAAP to U.S. GAAP.

What is GST/HST?

- The Goods and Services Tax (GST) is a 5% federal value-added tax that applies to most goods and services supplied in Canada
- Some provinces have a Harmonized Sales Tax (HST), combining the 5% GST with a provincial component to create a single combined rate of 13% (in Ontario) or 15% (in Nova Scotia, New Brunswick, Prince Edward Island, and Newfoundland)

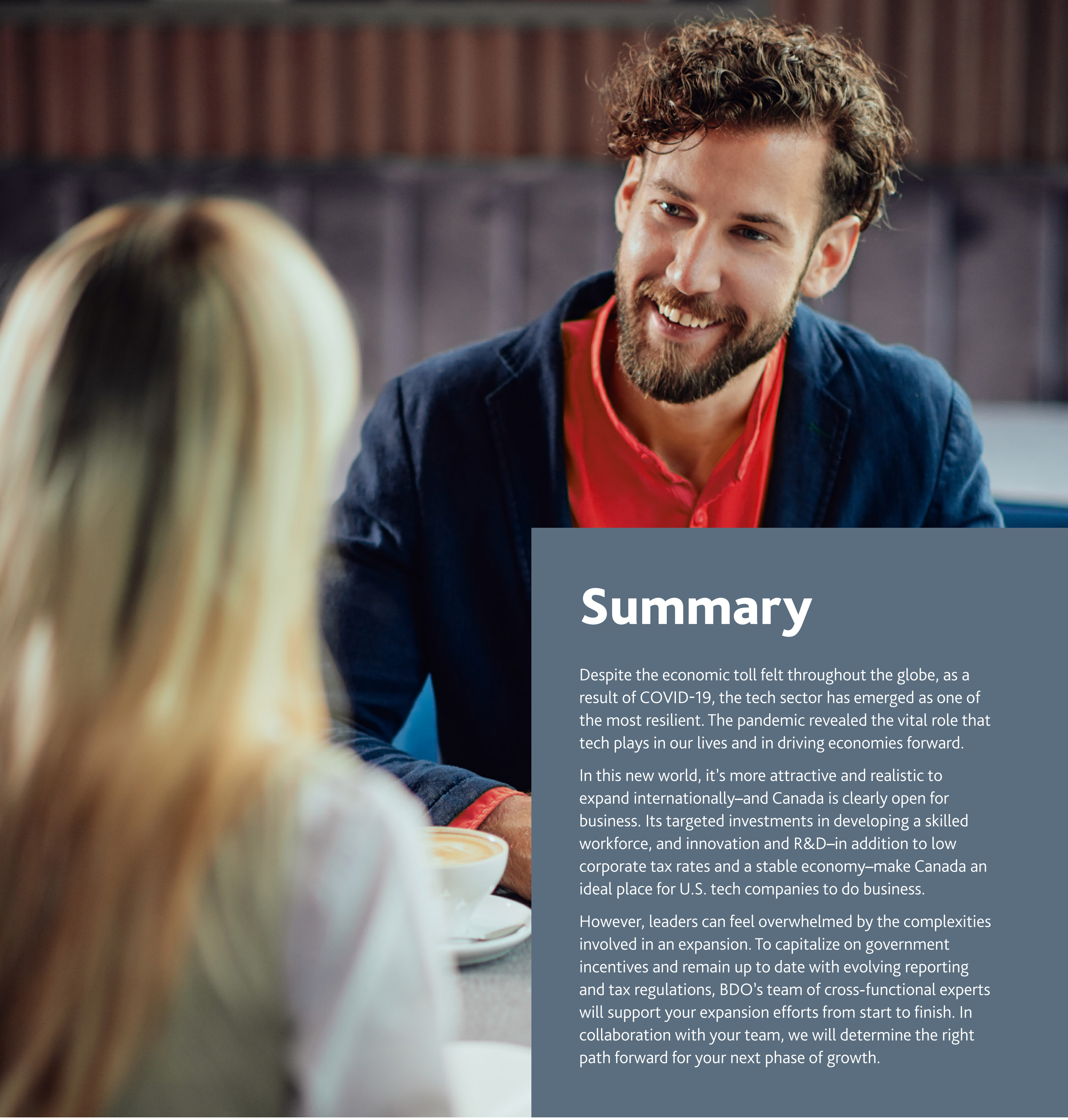
Businesses resident in Canada with annual sales of over $30,000 CAD on an associated basis are required to register for GST/HST. Businesses not resident in Canada are not required to register for GST/HST if they are not carrying on business in Canada. (Read more about GST/HST and provincial differences.)

New tax for digital services and products

Beginning July 1, 2021, Canada expanded its GST/HST registration and tax collection requirements. The changes require certain non-resident vendors and operators of online platforms to register for, collect, and remit GST/HST on:

- Sales of digital products and services provided to Canadian customers,
- goods supplied through fulfillment warehouses located in Canada and made by non-resident vendors directly through websites, and
- supplies made via short-term accommodation platforms.

This is an attempt to level the playing field between Canadian companies and foreign-based digital corporations (Netflix, Airbnb) that were largely exempt from paying federal sales taxes.



Summary

Despite the economic toll felt throughout the globe, as a result of COVID-19, the tech sector has emerged as one of the most resilient. The pandemic revealed the vital role that tech plays in our lives and in driving economies forward.

In this new world, it's more attractive and realistic to expand internationally–and Canada is clearly open for business. Its targeted investments in developing a skilled workforce, and innovation and R&D–in addition to low corporate tax rates and a stable economy–make Canada an ideal place for U.S. tech companies to do business.

However, leaders can feel overwhelmed by the complexities involved in an expansion. To capitalize on government incentives and remain up to date with evolving reporting and tax regulations, BDO's team of cross-functional experts will support your expansion efforts from start to finish. In collaboration with your team, we will determine the right path forward for your next phase of growth.

Sources

[1]Why invest in Canada?, Invest in Canada, 2021

[2]Canada Flexes its Tech Talent Muscle, CBRE, 2021

[3]Your Canadian Advantage Guide 2021, Invest in Canada, 2021

[4]Scientific research and experimental development tax incentive – Overview, Government of Canada, 2021

[5]Strategic Innovation Fund, Innovation, Science and Economic Development Canada, 2021

[6]Why invest in Canada?, Invest in Canada, 2021

Learn more about how BDO Canada can support your growth

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