MARCH 2012

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International Business Bulletin

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This newsletter is designed to highlight new issues of importance in international trade and business related law. We hope you will find it interesting and welcome your comments.

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REVIEW OF FOREIGN INVESTMENT IN CANADA

Henry J. Chang

Introduction

Foreign investments in Canada are regulated by the *Investment Canada Act* [1] (the "Act"). Its stated purposes are:

a) To provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada, and

b) To provide for the review of investments in Canada by non-Canadians that could be injurious to national security.

Industry Canada is the federal department primarily responsible for the administration of the Act. However, the Department of Canadian Heritage is responsible for the review and approval of foreign investments related to cultural industries.

The Act creates a process for notification or review of most foreign investments that will result in the establishment of a new Canadian business or the acquisition of control of an existing Canadian business. A discussion of this process and its effect on foreign investment in Canada appears below.

Application of the Act

The term "non-Canadian" is defined in Section 3 of the Act as an individual, government, agency or other entity that is not a Canadian. The term "Canadian" is defined in Section 3 to include the following:

a) A Canadian citizen;

b) A permanent resident within the meaning of Subsection 2(1) [2] of the *Immigration and Refugee Protection Act* [3], who has been ordinarily resident in Canada for not more than one year after the time at which he or she first became eligible to apply for Canadian citizenship;

c) A Canadian government, whether federal, provincial or local, or an agency thereof; or

d) An entity that is Canadian-controlled.

Therefore, any individual or entity that falls outside the above definition of "Canadian" must comply with the provisions of the Act.

Non-Canadians who engage in foreign investment in a Canadian business must either file a notification or an application for review of their investment, unless a specific exemption is avail-

[1] R.S. 1985, c. 28 (1st Supp.).

[2] Subsection 2(1) defines "permanent resident" as a person who has acquired permanent resident status and has not subsequently lost that status.

[3] S.C. 2001, c.27.

"...the expansion of an existing business is not subject to the notification requirements of the Act, unless it is relevant to Canada's cultural heritage or national identity."

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able. An extensive list of exemptions from the Act (other than Part IV.1, which relates to investments injurious to national security) appears in Subsection 10(1).

Investments Subject to the Notification Requirement

Notification requirements are described in Part III of the Act. According to Section 11, the following investments by non-Canadians are subject to the notification requirements:

a) An investment to establish a new Canadian business; and

b) An investment to acquire control of a Canadian business in any manner described in Subsection 28(1), unless the investment is reviewable.

The term "Canadian business" is broadly defined by Section 3 as a business carried on in Canada that has:

a) A place of business in Canada;

b) An individual or individuals in Canada who are employed or self-employed in connection with the business; and

c) Assets in Canada used in carrying on the business.

The term "new Canadian business," in relation to a non-Canadian, means a business that is not already being carried on in Canada by the non-Canadian and at the time of its establishment:

a) Is unrelated to any other business being carried on in Canada by that non-Canadian; or

b) Is related to another business being carried on in Canada by that non-Canadian but falls within a prescribed type of business activity that, in the opinion of the Governor in Council, is related to Canada's cultural heritage or national identity.

In other words, the expansion of an existing business is not subject to the notification requirements of the Act, unless it is relevant to Canada's cultural heritage or national identity. According to Schedule IV of the *Investment Canada Regulations* [4] (the "Regulations"), the following business activities are related to Canada's cultural heritage or national identity:

1) Publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine readable form;

2) Production, distribution, sale or exhibition of film or video products;

3) Production, distribution, sale or exhibition of audio or video music recordings; and

4) Publication, distribution or sale of music in print or machine readable form.

According to Section 28(1) of the Act, a non-Canadian acquires control of a Canadian business by:

a) The acquisition of voting shares of a company that carries on the Canadian business;

b) The acquisition of voting interests in a non-incorporated entity (i.e. a partnership, trust, or joint venture) that controls or carries on the Canadian business;

c) The acquisition of all or substantially all the assets of the Canadian business; and

[4] SOR/85-611.

"Review requirements are described in Part IV of the Act..., [which] makes a distinction between countries that are members of the World Trade Organization ("WTO") and those that are not. It also makes a distinction between direct and indirect acquisitions."

d) The acquisition of voting interests of an entity that controls, directly or indirectly, an entity in Canada carrying on the Canadian business.

Where an investment is subject to the notification requirements, the non-Canadian making the investment must, either prior to the implementation of the investment or within thirty days thereafter, give notice of the investment to the Director of Investments, in accordance with the regulations. If the notification is complete, the Director of Investments will send a receipt certifying the date upon which notification was received and advising the non-Canadian that:

i) The investment is not reviewable, or

ii) Unless the Director sends a notice for review within twenty-one days after the certified date, the investment is not reviewable.

Investments Subject to the Review Requirement

Thresholds

Review requirements are described in Part IV of the Act. Part IV makes a distinction between countries that are members of the World Trade Organization ("WTO") and those that are not. It also makes a distinction between direct and indirect acquisitions.

A direct acquisition involves the acquisition of voting shares of a Canadian corporation that carries on the Canadian business, voting interests in an unincorporated entity that carries on the Canadian business, or an asset transaction where the vendor is the Canadian business in Canada. An indirect acquisition is a transaction involving the acquisition of the shares of a parent company incorporated *outside of Canada*, which owns subsidiaries in Canada.

According to Subsections 14(3) and 14(4) of the Act, the thresholds for transactions involving non-WTO members are $5 Million for direct investments and $50 Million for indirect investments. WTO members benefit from much higher thresholds.

In accordance with Paragraph 14.1(2) of the Act, new thresholds for review for a WTO member, or where a Canadian business is ultimately controlled by a WTO member (other than a Canadian) prior to its acquisition, must be determined and become effective on January 1 of every year. The amount is equivalent to the growth in Nominal Gross Domestic Product at market prices as published by Statistics Canada for specified periods, multiplied by the amount determined for the previous year.

For 2011, the direct acquisition threshold for WTO members was $312 Million. Industry Canada has recently announced that this threshold is expected to increase to $330 Million for 2012; the official threshold will be published in the Canada Gazette in early 2012. Indirect acquisitions by WTO member investors are not reviewable but they are still subject to the notification requirements described in Part III of the Act.

Cultural Businesses

Notwithstanding the above, according to Subsection 15(a) of the Act, any investment subject to notification under Part III that would not otherwise be reviewable is reviewable under Part IV if it falls within a prescribed type of business activity that, in the opinion of the Governor in

"Guidelines published by Industry Canada refer to additional factors that should be considered when reviewing a proposed investment made by a State-Owned Enterprise ("SOE")."

Council, is related to Canada's cultural heritage or national identity. The business activities described in Schedule IV of the Regulations are considered prescribed business activities for the purposes of Subsection 15(a). The review thresholds for these business activities are $5 Million for direct acquisitions and $50 Million for indirect acquisitions, regardless of whether they involve WTO members.

Timing of Review

According to Subsection 16(1) of the Act, a reviewable investment may not be implemented prior to the investor having received a decision from the Minister that the investment is of "net benefit" to Canada. However, Subsection 16(2) contains three exceptions:

a) Where the Minister is satisfied that a delay in implementing the investment would result in undue hardship to the investor or would jeopardize the operations of the Canadian business and the Minister has sent a notice to the investor permitting implementation of the investment prior to completion of the review process;

b) Where the investment is implemented as the result of an acquisition of control of a corporation incorporated outside of Canada; and

c) Where the investment is not normally reviewable, but the Government exercises its authority by Order-in-Council to review the investment because the investment involves a Schedule IV business activity.

Criteria for Review

According to Section 20, in determining whether an investment will be of "net benefit" to Canada, the factors to be taken into account are as follows:

a) The effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;

b) The degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;

c) The effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

d) The effect of the investment on competition within any industry or industries in Canada;

e) The compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and

f) The contribution of the investment to Canada's ability to compete in world markets.

Guidelines published by Industry Canada refer to additional factors that should be considered when reviewing a proposed investment made by a State-Owned Enterprise ("SOE"). A SOE is an enterprise that is owned or controlled directly or indirectly by a foreign government.

"...the Minister has the authority to review any investment (either proposed or already implemented) made by a non-Canadian if there are reasonable grounds to believe that it may be injurious to national security."

When assessing whether a proposed acquisition by an SOE will be of net benefit to Canada, the Minister will also examine the corporate governance and reporting structure of the non-Canadian:

a) The Minister will consider whether the non-Canadian adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders), and to Canadian laws and practices.

b) The Minister will also consider whether a Canadian business to be acquired by a non-Canadian that is an SOE will continue to have the ability to operate on a commercial basis regarding:

   1) Where to export;

   2) Where to process;

   3) The participation of Canadians in its operations in Canada and elsewhere;

   4) Support of on-going innovation, research and development; and

   5) The appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

Although the factors that must be considered are clearly described in the Act and in Industry Canada's guidelines, there are still no clear guidelines regarding when a proposed transaction will be found to be of net benefit to Canada.

Investments Injurious to National Security

As a result of amendments enacted in 2009, the Minister has the authority to review any investment (either proposed or already implemented) made by a non-Canadian if there are reasonable grounds to believe that it may be injurious to national security. This authority appears in Part IV.1 of the Act.

According to Subsection 25.2(3), the Minister may require the non-Canadian (or any person or entity from which the Canadian business or the entity is being acquired) to provide any information that is considered necessary in determining whether there are reasonable grounds to believe that the investment could be injurious to national security. According to Subsection 25.3(1), if the Minister finds (after consultation with the Minister of Public Safety and Emergency Preparedness) that the investment could be injurious to national security, the Governor in Council may make an order for a review of the investment.

National security reviews are expected to be utilized infrequently and should normally be initiated only in cases where the Canadian business operates in military or other strategically-sensitive areas. For example, the mere fact that the proposed investment is being made by an SOE does not necessarily mean that a national security review will occur.

Recent Investment Reviews under the Act

For most of the Act's history, the process of reviewing and approving foreign investments has been little more than a formality. However, in recent years, two acquisitions have been blocked pursuant to the Act.

In May 2008, Industry Canada rejected a pro-

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posed takeover of MacDonald, Dettwiler and Associates Ltd. by a U.S. company, on the grounds that the sale would not be of net benefit to Canada. This was the first instance of a foreign investment being blocked by the Act.

In November 2010, Industry Canada blocked a $38.6 billion proposed takeover of Potash Corporation of Saskatchewan Inc. ("Potash Corporation") by BHP Billiton, an Australian-based company, on the basis that it would not be of net benefit to Canada. Potash Corporation produces about half of the World's supply of potash, a crucial ingredient used in fertilizers. Although it initially appeared as though the proposed takeover would be approved, both Potash Corporation and the Province of Saskatchewan aggressively lobbied Canada's Federal Government to block the deal. As a result of Industry Canada's negative decision, BHP Billiton withdrew its offer.

These recent decisions have only served to create greater uncertainty for foreign investors. The lack of clear guidelines regarding when a proposed transaction will be considered of net benefit to Canada, combined with the Federal Government's recent willingness to block such transactions, will likely discourage foreign investment in the future.

Conclusion

For foreign investments that fall below the applicable thresholds for review, the Act contains only a requirement to notify Industry Canada of the investment. However, foreign investors cannot ignore the potential issues that may arise when a proposed investment is subject to review under the Act.

As demonstrated by the Industry Canada's decision in the Potash Corporation case, one cannot predict exactly when an investment subject to review will be blocked. Although it may be possible to anticipate the likelihood of such action by considering political factors, in addition to those factors described in the Act, it is clear that Canada's process for reviewing foreign investments lacks predictability.

This lack of certainty in the review process only serves to discourage foreign investment, which is at odds with the Act's stated purpose of encouraging investment, economic growth and employment opportunities in Canada. ■

NEW TAX MEASURES DESIGNED TO BOOST FOREIGN INVESTMENT

Paul L. Schnier

Governments across the world are searching in these early post-recession days for measures that will continue to help create a new era of sustainable economic vigour and the business and personal prosperity that go with it. It seems clear that part of the Government of Canada's plan is to promote more foreign direct investment in this country.

Foreign direct investment plays a crucial role in Canadian business. Not only does it provide a significant portion of the capital for economic growth, but it brings in new management expertise, technology and value-added jobs. This growth seems destined to continue and perhaps even accelerate as Canada's historic social and political stability and its watchful approach to banking regulation continue to help the country

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stand out in bold relief as a safe haven for international investment.

And in addition to those strengths, we now have a number of significant tax changes, one of which will reduce taxes collected and should lead to a substantial increase in the venture capital investment that foreigners are prepared to make in Canada.

Until recently, non-residents have had to deal with a complex withholding and reporting regime when disposing of their Canadian investments. These requirements are now eased significantly.

Under our current legislation, when a non-resident disposes of taxable Canadian property to a Canadian resident, he must first obtain a clearance certificate from the Canada Revenue Agency ("CRA"). This is done through a filing with the CRA and often involves paying an amount or posting security with respect to any applicable taxes, or satisfying the CRA that no tax is payable.

Unless the purchaser receives this clearance certificate, he is obliged to withhold 25 percent of the purchase price from the sale proceeds on account of the vendor's potential tax liability. One can easily see the distress that would be caused where, for example, the clearance certificate is not produced in time for closing or where the purchase price is not paid in cash.

"Taxable Canadian Property" has, until recently, included Canadian real property and items akin to real property, such as resource properties and timber limits. It has also included shares of private companies as well as shares of public companies where 25 percent or more of any class of shares of the public company are held by one or more members of a family group.

This definition has been amended so that the foregoing types of shares will only constitute taxable Canadian property where they derive more than 50 percent of their value principally from Canadian real estate, resource properties or timber limits held by the company at any time in the 60 month period preceding the date of sale.

In other words, shares of private companies or shares of a closely held public company will be subject to the old withholding and reporting regime only where the companies are, or have been, involved in the real estate, resource or forestry sectors. This allows for a wide array of companies, such as those in the high tech, manufacturing and retail sectors (which are intensive in technology and value-added employment) to attract foreign investment without the concern that any gains realized on these investments will be subject to Canadian tax.

Also, it is important to note that this new law applies to investments by any non-resident. Formerly, certain investors who were resident in a country with which Canada had a tax treaty would have enjoyed some relief from this taxation. The change applies equally to both residents of a treaty jurisdiction, such as the United States or Japan, as well as those resident in jurisdictions with which Canada does not have a tax treaty, such as Hong Kong.

This means everyone is now on a level playing field and there is no reason to engage in complicated investment structures utilizing treaty jurisdictions. This amendment should open up

Canadian investment to all comers and thus further enhance our global competitiveness as a place to invest.

In a parallel move, the new legislation makes it easier for non-residents to obtain refunds where more funds than necessary have been withheld by a purchaser under the clearance certificate procedure. Both amendments are important moves in the right direction to attract greater international investment to Canada. ■

International Business Bulletin is a publication of the International Trade and Business Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Kylie Aramini at 416 593.7221 ext. 3600 or by email to karamini@blaney.com. Legal questions should be addressed to the specified author.

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