

How to start a business in Canada: What structure should global companies choose?

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This article is part of a practical series written for international companies looking to establish, launch, operate or invest in a business Canada. Each article covers a major area of law in Canada — everything from employment laws to taxes. Access all the articles on the "Doing business in Canada: A practical guide from 'Eh' to 'Zed'" page.

One of the threshold issues for a foreign entity to consider when seeking to establish a business in Canada is what form the business should take. The form selected should reflect both operational and tax considerations. The foreign entity will need to determine whether that business should be carried on directly, as a branch of the foreign entity, or should be created as a separate Canadian business organization, such as a subsidiary corporation (with either limited liability or, in some provinces, unlimited liability), a sole proprietorship, a partnership (which may be a general partnership or limited partnership, or possibly a limited liability partnership), or various forms of joint venture. Additionally, the foreign entity may choose to acquire an existing Canadian business or an interest in such a business. Generally speaking, a foreign entity may carry on business directly in Canada through a branch, but will likely be subject to federal and provincial registration requirements.

Branch or subsidiary

A number of issues should be considered in choosing whether to operate as a branch or as a subsidiary. If the Canadian operation is expected to incur significant losses in its early years of operation, the foreign entity may wish to carry on business in Canada directly through a branch in order to deduct those losses for foreign tax purposes, if possible. A Canadian branch structure might also enable a better matching of the Canadian corporate tax paid with the foreign tax credits available in the home jurisdiction.

Many foreign investors prefer to carry on business in Canada through a Canadian subsidiary. A subsidiary is more convenient for administrative purposes and can make the process of contracting in Canada simpler. Operating through a Canadian subsidiary generally limits the liability of the foreign parent corporation to its capital investment in the Canadian subsidiary. A foreign parent corporation conducting business through a branch office is directly responsibility for liabilities of the Canadian operation.



For a discussion of the tax issues that should be considered in determining whether to carry on business in Canada through a branch or subsidiary, see <u>Taxation in Canada</u>.

Corporations

A corporation is the most common form of legal entity for businesses. Most foreign businesses operating in Canada adopt a corporate form. Because a corporation is a legal entity that is separate and distinct from the shareholders who contribute to the corporation's capital, generally shareholders are not responsible for the debts, liabilities or obligations of the corporation. In addition, the corporation enjoys perpetual succession, continuing despite the death of any or even all of its shareholders.

(a) Federal or provincial incorporation

Corporations may be created in Canada under either federal or provincial/territorial legislation. Accordingly, assuming a decision has been made to incorporate in Canada, a choice must then be made regarding the jurisdiction under which the entity should be incorporated. In most cases, the jurisdiction of incorporation does not affect whether federal or provincial laws will apply in areas of dual jurisdiction, as in the case of Canada's labour laws. Corporations established under federal or provincial/territorial legislation may carry on business anywhere in Canada as of right, but are required to comply with certain provincial requirements such as extra-provincial registrations.

In most Canadian jurisdictions, governing legislation permits corporations to adopt a unanimous shareholders' agreement. Such agreements have the effect of transferring certain of the directors' powers to the shareholders. To the extent that these powers are transferred to the shareholders, the directors are generally relieved of liability and the shareholders are then subject to the duties and liabilities normally attributed to the corporate directors.

This arrangement can be useful in the case of a foreign corporation that wishes to limit the powers of the Canadian subsidiary's directors over subsidiary operations, especially where the subsidiary and the foreign parent have different directors.

(b) Public and closely held or private corporations

Canadian law distinguishes between public corporations, which distribute their securities to the public, and closely held or private corporations, which have a limited number of shareholders and restrict the transferability of their securities in some manner. Although public corporations are subject to more stringent requirements concerning public disclosure and to potentially differing income tax rules, the most fundamental principles of corporate law, including limited liability of shareholders, apply to all corporations (other than unlimited liability companies as discussed below).

(c) Unlimited liability companies

An unlimited liability company (or a ULC) is a form of corporation where the company shareholders can be held liable for the ULC's obligations. In this respect, a ULC is similar to a general partnership and differs from the common form of corporation where



the corporation's shareholders are not, in general, held accountable for the liabilities, acts or omissions of the corporation.

A ULC can be formed under the laws of Alberta, British Columbia, Nova Scotia or Prince Edward Island. The corporate legislation in each provincial jurisdiction is different, so creating a ULC requires an assessment of the advantages and disadvantages of each jurisdiction before the ULC is formed. Additionally, the possibility of shareholder liability under a ULC should also be carefully assessed and mitigated.

The viability of forming as an ULC must also be considered from a tax perspective. For example, for U.S. tax purposes, a ULC is generally regarded as a flow-through entity which means that shareholders will be responsible for taxes. Professional advice should be obtained to fully consider the tax implications of establishing a ULC.

(d) Capital structure

Canadian federal or provincial/territorial corporate statutes permit considerable flexibility in the design of a corporation's share structure. For example, shares can be voting or non-voting, they can have limited or unlimited participation in equity, and they can be redeemable for a fixed price at the option of the corporation or the holder. Shares can also be given special voting rights with respect to certain matters, such as the appointment of directors and the acquisition or disposal of significant assets.

Through careful selection of share characteristics, it is possible to separate capital contributions and control from participation in future profits. This possibility is particularly useful in designing share structures for joint ventures and in addressing taxation issues.

On occasion, foreign parents may want to capitalize their Canadian subsidiaries through debt rather than share capital. In general, Canadian corporate legislation does not require any minimum investment by way of share capital. However, the financing of a corporation largely by debt may lead financial institutions to require a guarantee from the foreign parent. It may also have income tax implications, as discussed below.

In most provinces, the amount of authorized capital of a corporation does not affect either the incorporation or the registration fee. Accordingly, a company's authorized capital should not be a major consideration in determining the company's share structure.

(e) Residency of directors

The federal Canada Business Corporations Act (the CBCA) requires that at least one quarter (25%) of the directors of most federal corporations be resident Canadians. For CBCA corporations doing business in certain industries, such as book publishing, film or video distribution, and uranium mining, the residency requirement for directors is higher. Some provinces also impose residency requirements for directors.

To be a resident Canadian for federal purposes, a person must generally be either a Canadian citizen resident in Canada, or a permanent resident under the federal Immigration and Refugee Protection Act. In addition, subject to some limited exceptions,



a person must already be ordinarily resident in Canada in order to be considered to have resident status.

(f) Corporate and trade names

Whether operating as a branch office or as a subsidiary, corporations must register in each province and territory in which they will be conducting business. Corporations are registered in Canadian jurisdictions under their corporate names. Some provinces and territories impose approval requirements on corporate names. That registration does not, in and of itself, give the corporation any proprietary interest in the corporate name. It does, however, provide the corporation with some practical protection for its name since the corporate registrars in certain jurisdictions will typically refuse to register a corporation under a name that is the same as, or substantially similar to, that of an existing corporation in that jurisdiction.

To better protect a corporation's name that is used in association with its goods or services, the name can also be registered as a trademark under the federal Trademarks Act. Registration gives the owner of the trademark the exclusive right to use the trademark in association with its goods and services throughout Canada.

If a corporation operates in Québec, it must comply with specific requirements with respect to its name. These requirements are discussed in <u>Canadian Language Laws</u>.

If a corporation wants to conduct business using a name other than its corporate name, some provinces require the corporation to register this so-called "trade name". In most provinces, the name cannot be the same as, or similar to, that of another corporation (except in certain specified circumstances). Registration of a trade name does not, in and of itself, give the corporation a proprietary interest in the trade name. However, once a corporation establishes a reputation in association with the trade name, it may, in certain circumstances, preclude other businesses from using the same trade name. It is also possible to trademark trade names.

Some provinces are more flexible than others in granting registration to foreign corporations whose corporate name may be confused with that of a previously registered corporation. In some jurisdictions the foreign corporation cannot be registered unless it changes its corporate name. In other jurisdictions, the registrar will approve the registration on receiving the foreign corporation's undertaking that it will operate under a pseudonym within that jurisdiction.

Sole proprietorships

The simplest form of business organization, a proprietorship, is a sole owner business that is not incorporated. At law, there is no distinction between the proprietorship and the owner and as a result the proprietorship's income, tax liability and other liabilities are regarded as those of the owner. Income of the proprietorship is included in the calculation of the owner's taxable income. While there are few requisite formalities for creating a proprietorship, in some cases there may be licensing and registration requirements. Also, if the owner wishes to carry on business using a name that is different from his or her own individual name, that name may first need to be registered with the applicable provincial government.



Limited partnerships

A limited partnership is something of a legal hybrid, providing certain benefits of a limited liability company along with many of the tax benefits of a partnership. Generally, there must be one or more general partners who are liable for all the partnership's debts. There may also be any number of limited partners whose liability is limited to the amount they contribute. Generally, a limited partner is not permitted to take any part in the management or control of the partnership's business. A breach of this requirement exposes the limited partner to liability as a general partner. However, a limited partner may participate in certain fundamental decisions, such as the admission of new general partners, the winding up of the partnership or its expansion into new businesses. A comprehensive partnership agreement is required to address these issues.

Partnerships

(a) Generally

A partnership generally exists when two or more individuals or entities carry on business together with a view to making profit without incorporating. In an ordinary partnership, the partnership is not a separate legal entity, and all the liabilities of the partnership are personal liabilities of the partners. An exception exists in Québec, where (although not recognized as a legal person distinct from that of its partners) a partnership possesses some of the characteristics of a legal person, such as a partnership name, a partnership head office and legal standing in court. The assets and liabilities of a Québec partnership are also considered to be distinct from those of its partners, and creditors must first take recourse against partnership assets before calling on the personal liability of the partners for any shortfall.

A number of provinces and territories recognize a second type of partnership: the limited partnership, where the liability of at least one partner (the general partner) is unlimited and the liability of any other partner(s) (limited partner(s)) is limited to the amount the individual limited partner contributed to the business.

Generally, partnership income is not taxed at the partnership level, but rather is taxed in the hands of the individual partners. Each partner will be taxed on his or her proportionate share of the partnership income and on any capital gain realized when the partner disposes of his or her interest in the partnership. See <u>Taxation in Canada</u>.

(b) Limited liability partnerships

Some provinces allow professional firms such as law firms and accounting firms to carry on business as limited liability partnerships. In British Columbia, a limited liability partnership may be used for any type of business venture. The benefit of a limited liability partnership is that a partner is generally only liable for the partner's own negligent or wrongful acts or omissions or for the negligent or wrongful acts or omissions of another partner or an employee of the partnership, if the partner knew of such acts or omissions and failed to take the actions that a reasonable person would take to prevent them.



Joint ventures

There is no precise legal definition of the term "joint venture" in Canada. It generally refers to any means whereby two or more economic entities share in a common venture. It can refer to joint venture corporations, to partnerships of corporations or, most commonly, to a structure (usually referred to as a contractual joint venture) under which separate corporations own certain assets in common with the expectation that the venture does not constitute a partnership, at least for tax purposes.

Typically, in any joint venture, profits and losses are not calculated at the joint venture level, except in the case of a partnership or a joint venture corporation. Instead, each coventurer contributes assets or cash to cover expenses and shares in any revenue generated from those assets in the agreed proportion. Depreciation and the calculation of profits and losses are determined for each co-venturer separately.

A potential disadvantage of a contractual joint venture is that a court may conclude, after examining the situation and the conduct of the parties, that a type of partnership was created, notwithstanding that the contract may expressly state that the parties did not intend to create a partnership. If such a determination is made, the parties may find themselves subject to laws and liability that they may have intentionally sought to avoid via contract.

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