

### **3. LIMITATIONS ON NON-RESIDENT INVESTMENT**

#### **3.1 Introduction**

Non-Canadians who acquire control of an existing Canadian business or who wish to establish a new unrelated Canadian business are subject to the *Investment Canada Act* (the "ICA") which provides for the reporting and the potential review of significant investments made in Canada by non-Canadians.

As a result of the Canada-United States Free Trade Agreement ("FTA") and the North American Free Trade Agreement ("NAFTA"), the review requirement of the ICA was effectively removed from a large majority of acquisitions involving purchasers and vendors controlled by Mexicans or Americans. With the conclusion of the General Agreement on Tariffs and Trade round of international trade negotiations, the creation of the World Trade Organization ("WTO"), as well as the amendments to the ICA which became effective January 1, 1995 (the "1995 Amendments"), liberalized rules now confer benefits on purchasers or vendors controlled by persons resident in WTO member states. Currently, Bill C-10 introduced by the Canadian government and which will likely come into force at the end of March, 2009, makes further changes to the ICA so that the review of an investment will be applied only to the more significant investments.

If the proposed amendments to the ICA receive Royal Assent, the ICA will no longer represent a constraint to ordinary commercial activity with one important caveat. The financial threshold for review of an investment by a WTO or a NAFTA investor is expected to be increased to \$600 million based on the value of the enterprise. Further increases to the threshold to a total of \$1 billion are expected within four years. However, any investment would be subject to review if it would threaten national security. In such circumstances, the amendments allow the Governor in Council to take any measures that the Governor in Council considers advisable to protect national security, such as prohibiting a non-Canadian from implementing an investment.

Currently, the threshold of review is determined by the Minister of Industry each year and in 2009, the threshold for review for vendors or investors residing in WTO member states (including NAFTA members) was determined to be \$312 million dollars. For investors outside of the WTO or NAFTA, the thresholds for transactions which are subject to review are 5 million dollars for direct investments and 50 million dollars for indirect transactions.

Notification requirements, however, continue to exist for all transactions that fall below the established thresholds. Indirect acquisitions by WTO or NAFTA member investors are not reviewable, but are nonetheless subject to notification.

Certain sectors of the economy continue to be excluded from the new liberalized rules, in particular acquisitions of control of businesses involving uranium production, financial services, transportation or "cultural" businesses (book publication, radio and television broadcasting, film, video or audio production, distribution, sale or exhibition). These sectors remain subject to special rules under the ICA or under other statutes.

By eliminating the review requirement for most transactions, a procedural hurdle has been all but eliminated, making investment in Canada significantly easier for investors able to take advantage of the new liberalized rules.

#### **3.2 Investment Canada Act**

The ICA came into force on June 30, 1985, with the stated purpose being:

(a) to encourage investment in Canada that contributes to economic growth and employment opportunities; and

(b) to provide for the review of significant investments in Canada by non-Canadians to ensure such benefit to Canada.

The ICA establishes a two-tiered system of notification and review. Where a non-resident investment exceeds specified monetary thresholds and does not involve a sensitive business activity (such as banking, insurance, broadcasting and some types of mining), the investor must simply notify the Investment Review Division of Industry Canada ("Industry Canada") of the investment but no actual review will take place. In the case of specific cultural activities, the Department of Canadian Heritage ("Canadian Heritage") must be notified. Where a review is required, the non-resident investor must show that the investment is likely to be of "net benefit" to Canada, a less stringent test than the "significant benefit" test formerly required under the *Foreign Investment Review Act* (Canada). The ICA distinguishes the acquisition of control of an existing business from the establishment of a new business and in the latter case eliminates the requirement for review.

### **3.3 Exemptions from the ICA**

This receptive attitude to non-resident investment is illustrated by the significant number of exemptions from the ICA which may be summarized as follows:

- (a) acquisitions by traders or dealers in voting securities in the ordinary course of their business;
- (b) acquisitions in the ordinary course of business of providing venture capital in Canada;
- (c) acquisitions of control of Canadian businesses resulting from realizing on the security granted for loans or other financial assistance;
- (d) acquisitions of control of Canadian businesses for the purpose of facilitating financing provided that the acquirer divests control within two years;
- (e) acquisitions of control of Canadian businesses by reason of corporate re-organizations which do not result in a change in ultimate control;
- (f) acquisitions of control of Canadian businesses from a federal or provincial government or Crown corporation;
- (g) acquisitions from certain tax-exempt municipal or provincial corporations, commissions or associations;
- (h) the acquisition or establishment of Canadian chartered banks;
- (i) the involuntary acquisition of control of Canadian businesses on the devolution of estates or by operation of law;
- (j) certain acquisitions by insurance companies of insurance businesses and acquisitions by non-residents of interests in federal insurance companies; and
- (k) acquisitions of control of Canadian businesses the revenue of which is generated from farming carried out on the real property acquired in the same transaction.

### **3.4 Notifiable Investments**

The purpose of the notification requirement appears to be twofold: firstly, it allows the Canadian government to maintain some control of sensitive sectors relating to Canada's cultural heritage and national identity; and, secondly, it allows for the monitoring of the level and nature of non-resident investment in Canada.

A non-Canadian is required to give notice to Industry Canada of every investment, regardless of size, intended to establish a new business in Canada which is not related to another business already carried on in Canada by the non-Canadian. Notice must also be given where a non-Canadian acquires control of an existing Canadian business where the value of the assets of all the Canadian entities over which control is acquired is less than specified thresholds. Currently, the basic threshold is \$5 million but if control of the entity in Canada carrying on the Canadian business is acquired indirectly through the acquisition of control of a non-Canadian corporation it is increased to \$50 million. Where the investor is a WTO member (including American or Mexican) or the Canadian business being acquired is controlled by a WTO member, the basic threshold for review for direct acquisitions has been increased to \$312 million in 2009 and for indirect acquisitions has been eliminated in consequence of the 1995 Amendments and NAFTA.

Similarly, in 2009 investments originating in a WTO member state are only reviewable if the investment results in a direct acquisition or control of a Canadian business that has assets equal to or greater than \$312 million. If a WTO investor directly acquires a business in Canada with assets of less than \$312 million the investment is nevertheless notifiable. All indirect WTO investor acquisitions are not subject to review and are also not subject to notification provided the absolute value of the Canadian business acquired represents less than 50% of the total amount of the international transaction even if the value of the assets being acquired exceeds \$312 million. The current list of WTO members consists of most developed economies, including all of the major European countries (excluding Switzerland).

As discussed in Section 3.1, the proposed amendments to the ICA drastically change the threshold values for WTO investors. The amendments state that despite the limits set out in the ICA, a WTO investor is reviewable only if the enterprise value exceeds \$600 million, with further increases to \$1 billion within four years of the coming in force of the amendments. The value of the threshold thereafter will be determined by the Minister according to a formula determined by the statute.

These changes do not apply to uranium production or development businesses, financial service businesses other than insurance services, transportation service businesses and cultural businesses including radio and television broadcasting and cable transmission businesses to which the \$5 million and \$50 million thresholds described above remain applicable to American, Mexican and WTO investors and American-controlled, Mexican-controlled and WTO investor-controlled Canadian businesses.

In the great majority of cases involving Americans, Mexicans or WTO investors, it will not be necessary to file an application for review and to obtain approval before completing a transaction. Instead, notification of the transaction must simply be provided to Industry Canada. The review thresholds outlined above are adjusted annually by the Minister to reflect economic growth in Canada and are published in the *Canada Gazette*.

### **3.5 Notification Procedure**

Where notification is required, the investor must file with Industry Canada a brief statement of information about the investment prior to or within 30 days of implementation. The notice requires only rudimentary information about the investor and the nature of the investment. Industry Canada must issue a receipt upon receiving a properly completed notice in which it must certify either that the investment is not reviewable or that it is not reviewable unless Industry Canada sends a notice requiring a review within the next 21 days. If this period elapses without notification from Industry Canada then the investment is not reviewable. A determination to review an investment may be made if the investment is related to Canada's cultural heritage or national identity.

### **3.6 Cultural Heritage and National Identity**

Where an investment involves business activities prescribed under the ICA as being related to Canada's cultural heritage or national identity, a review can be required although one would not otherwise be requested. Should the investment relate to any of these activities, Canadian Heritage becomes responsible

for the administration of the ICA. The types of business activities considered to be related to Canada's cultural heritage or national identity are:

- (a) publication, distribution or sale of books, magazines, periodicals or newspapers or music in print or machine-readable form; and
- (b) production, distribution, sale or exhibition of film or video products and audio or video music recordings.

In order to strengthen the book publishing and distribution industry, the Canadian government has revised several of its key foreign investment policies in this sector. Any foreign investment in a new business in this industry is limited to Canadian-controlled joint ventures and non-Canadians are generally not permitted to acquire an existing business under Canadian control. In addition, where a non-Canadian seeks to sell an existing Canadian business, all potential Canadian investors must be given a fair opportunity to purchase it.

In 2002, new Guidelines were published which create dual filing requirements for those businesses engaged in both cultural activities and other business activities. The requirements exist irrespective of the proportion of these businesses included in the transaction. Both Industry Canada and Canadian Heritage must be contacted if a non-Canadian intends to establish or acquire direct or indirect control of such a business. However, whether each department requests a notification or an application of review will depend upon the nature of the acquisition and the foreign country involved. Due to the special status afforded to NAFTA and WTO members, in certain instances only a notification will be required when an application for review would otherwise be necessary.

### **3.7 Reviewable Investments**

In addition to investments involving business activities related to Canada's cultural heritage or national identity, the ICA also requires a review and approval procedure whenever a non-Canadian, other than an investor resident in a NAFTA or WTO member state, makes an investment to acquire control of a non-exempt Canadian business in the following circumstances:

- (a) the acquisition of the voting shares of, or substantially all of the assets used in carrying on, the Canadian business where the value of the assets acquired is \$5 million or more;
- (b) the acquisition of voting interests in a non-corporate entity (a trust, partnership or joint venture) carrying on the Canadian business or of another such entity which controls it, either directly or indirectly, so long as control of a corporation is not acquired in the transaction, where the value of the assets of all Canadian entities is \$5 million or more;
- (c) the acquisition of voting interests in an enterprise which controls an entity in Canada carrying on the Canadian business, so long as control of a non-Canadian corporation which controls the Canadian entity is not acquired, where the value of the assets of all Canadian entities acquired is \$5 million or more; and
- (d) the acquisition of voting interests in an enterprise which controls an entity in Canada carrying on the Canadian business in which control of a non-Canadian corporation which controls the Canadian entity is acquired:
  - (i) if the value of the assets of all Canadian entities acquired amounts to more than 50% of the value of all assets acquired, the value of the Canadian assets is \$5 million or more; and
  - (ii) if the value of the assets of all Canadian entities acquired amounts to 50% or less of the value of all assets acquired, the value of the Canadian assets is \$50 million or more.

Under the above scheme, a review of the investment is not needed where control of a non-Canadian corporation is acquired and the Canadian business is not carried on by an entity in Canada but rather through a branch of a non-Canadian entity.

Investments involving Americans, Mexicans and WTO investors which are not otherwise reviewable which fall within the prescribed activities related to Canada's cultural heritage and national identity, as described above, remain subject to discretionary review even though Americans, Mexicans or WTO investors are involved.

Additionally, if the proposed amendments to the ICA contained in Bill C-10 come into effect, any investment could become reviewable if it could be judged to be injurious to national security notwithstanding whether or not the investment was being made by a WTO investor.

### **3.8 Net Benefit to Canada**

In order to ensure that significant investments by non-Canadians are beneficial to Canada, the Minister responsible for administering the ICA must be satisfied that the investment is likely to be of net benefit to the country. The Minister is required to take a number of specified factors into account in assessing the investment. These factors include, where relevant, the effect of the investment on the level of economic activity in Canada in such areas as employment, resource processing, utilization of parts, components and services produced in Canada and exports from Canada, participation by Canadians in the business and the industry, productivity, industrial efficiency, technological development and innovation, competition, compatibility with national and provincial industrial, economic and cultural policy objectives, and the contribution of the investment to Canada's ability to compete in world markets.

Since a potential investment may be jeopardized if the non-resident investor cannot demonstrate a positive effect on a number of these factors, it is advisable to consider the potential impact of the investment in terms of the various factors which will be assessed during the review process before any steps are taken. The guidance of Canadian advisers with both expertise and familiarity with the ICA is invaluable at this early stage. Our experience indicates that if the material to be submitted to Industry Canada is thoughtfully prepared, most investments readily pass the "net benefit" test.

### **3.9 Canadian Status**

Investors who must be concerned with compliance with the ICA are those who are not included within the definition of "Canadian" in the ICA. "Canadian" includes Canadian citizens wherever residing, permanent residents of Canada who have been ordinarily resident in Canada for not more than one year after becoming eligible to apply for Canadian citizenship, Canadian governments and their agencies and Canadian-controlled entities.

Non-Canadians (i.e. individuals, governments or agencies thereof and entities which are not Canadian) must comply with the ICA upon the establishment of a new Canadian business or the acquisition of control of an existing Canadian business. This includes the notification requirements discussed under Section 3.4 and the review requirements for those investments that are higher in value than the thresholds established for investors detailed under Section 3.7 or otherwise falling under an exception.

The ICA provides a series of rules for determining whether corporations and other entities (i.e., partnerships, trusts and joint ventures) are Canadian-controlled. An entity will be considered to be Canadian-controlled if:

- (a) a Canadian or members of a voting group who are Canadian own a majority of the voting interests;
- (b) Canadians own a majority of voting interests so long as the entity is not controlled in fact by non-Canadians;

(c) the entity is controlled in fact by Canadians so long as a majority of voting interests are not owned by non-Canadians; and

(d) where there is no control in fact, less than 2/3 of the board of directors of a corporation, of the general partners of a limited partnership or of the trustees of a trust are Canadian.

Where two persons own equally all of the voting shares of a corporation and one of them is a non-Canadian, the corporation is deemed not to be Canadian-controlled.

A corporation incorporated in Canada, the voting shares of which are publicly traded in the open market, will be deemed to be Canadian if it can be established to the satisfaction of the Minister that during at least the immediately preceding year the majority of its voting shares have been owned by Canadians, 80% of the members of its board of directors have been Canadian citizens ordinarily resident in Canada, its chief executive officer and three of its four most highly remunerated officers have been Canadian citizens ordinarily resident in Canada, its principal place of business has been located in Canada and its board of directors supervises the management of its business affairs on an autonomous basis without direction from any shareholder other than through the normal exercise of voting rights at meetings of its shareholders. Where such criteria have been met the corporation will be deemed to be Canadian for two years from the date on which the Minister notifies the corporation of the determination or until such time as there has been a substantial change in the material facts.

### **3.10 Special Status Under NAFTA/WTO**

For the purpose of applying the review thresholds now applicable to Americans and Mexicans, a series of rules have been adopted for determining whether an individual or corporation or other entity is an American, Mexican or resident of a WTO member state and whether a corporation or other entity is American-controlled, Mexican-controlled or WTO investor-controlled. An entity will generally be considered American, Mexican or WTO based if it is American-controlled, Mexican-controlled or WTO investor-controlled and the applicable rules for ascertaining control are similar to those for determining whether an entity is Canadian-controlled. If an American, Mexican or a WTO investor and a Canadian own equally all the voting shares of a corporation, the corporation will be deemed to be American-controlled, Mexican-controlled or WTO investor-controlled.

### **3.11 Canadian Business**

The requirements of the ICA only become relevant when a non-Canadian proposes to acquire control of or establish an active business in Canada. While "active business" is not a term used in the ICA, activity is implied by the definition of "business" which includes any undertaking or enterprise capable of generating revenue and carried on in anticipation of profit. Accordingly the mere acquisition of property in Canada does not in itself constitute a notifiable or reviewable investment. However, the establishment or acquisition of control of any such undertaking or enterprise carried on in Canada that has a place of business in Canada, an individual or individuals in Canada who are employed in connection with the business, and assets in Canada used in carrying on the business, and that consequently falls within the definition of Canadian business, will constitute a notifiable or reviewable transaction.

### **3.12 New Canadian Business**

Where a non-Canadian proposes to establish a new Canadian business such establishment will constitute a notifiable investment and may also be reviewable. New Canadian business is defined to mean a business that is not already being carried on in Canada by the non-Canadian and that, when established, is either unrelated to any other business being carried on in the nation by that non-Canadian or which, although related to another business being carried on in Canada, falls within a prescribed type of business activity that is related to Canada's cultural heritage or national identity. Again, the mere ownership of property or business assets or the investment in such property or assets will not fall within the purview of the ICA. However, actively trading in or otherwise utilizing such property or assets to generate income

will be viewed as the carrying on of a business and, accordingly, commencing such utilization will activate the notification or review requirements of the ICA.

### **3.13 Acquisition of Control**

A notifiable or reviewable acquisition of control can be accomplished either through the procurement of voting shares of a corporation (or voting interests of a non-corporate entity) or through the attainment of all or substantially all of the property used in carrying on the business being acquired.

A Canadian business may be carried on partly in Canada and partly elsewhere. In the case of an acquisition of property partly situated in Canada and partly situated elsewhere, the business will be a Canadian business and subject to the ICA so long as it has a place of operation and employees in Canada.

In the case of an acquisition of shares, the acquisition of control of a foreign corporation through the acquisition of voting shares will be subject to the ICA if that foreign corporation has a subsidiary incorporated, or other entity located, in Canada and carrying on business in Canada. However, the acquisition of control of the foreign corporation through the acquisition of its voting shares would not be subject to the ICA if it carries on business in Canada through an unincorporated branch. An acquisition of any other foreign entity with a branch in Canada would be an acquisition of control subject to the ICA.

The ICA provides a series of rules which determine whether a controlling interest in an entity has been acquired. The ICA deems acquisition of a majority of the voting interests of an entity to be acquisition of control of the entity. Where less than a majority of the voting interests of an entity are being acquired and the entity is not a corporation, control of the entity is deemed not to be acquired. In the case of a corporation, however, the presumption that control is not being acquired applies only where less than one-third of the voting shares of the corporation are being acquired. Where less than a majority but one-third or more of the voting shares of a corporation are being acquired, acquisition of control of the corporation is presumed unless it can be established that the acquirer has not gained control in fact.

### **3.14 Written Opinions, Guidelines and Interpretation Notes**

It can be difficult to determine whether the circumstances of any particular transaction render it liable to notification or review under the ICA. In recognition of this problem, the Minister is required, upon receipt of an application and sufficient information, to provide a written opinion as to whether an individual or an entity is Canadian or an American, a Mexican or a WTO member. Additionally, when an application is made for an opinion as to the applicability of any other provision of the ICA or the regulations thereunder, the Minister has a discretion to provide the applicant with a written opinion for her/his guidance. Written opinions are binding on the Minister so long as the material facts on which the opinion was based remain substantially unaltered.

The ICA also provides that the Minister may issue and publish Guidelines and Interpretation Notes in order to clarify the application and administration of any provision of the ICA or the regulations. Guidelines have been published to assist investors in determining whether a new business established in Canada is related to an existing Canadian business and accordingly not subject to notification, to assist investors in determining whether acquisitions of interest in oil and gas properties are subject to notification or review, and with respect to administration procedures in connection with the review of proposed investments and monitoring after approval.

Several Interpretation Notes have been issued to assist in interpretation of the definitions of "business" and "Canadian business" in the ICA.

Counsel for the non-resident investor must carefully review the facts and the law, consult informally with Industry Canada and formulate an opinion as to whether or not the transaction is reviewable. The non-resident investor must either rely on the advice delivered by counsel, obtain an opinion from the Minister (if available in the circumstances) or submit the proposed transaction to the full review process. Experience indicates that many of the non-resident investor's concerns can be dealt with by way of legal

opinions from counsel rather than by making the formal applications and disclosures necessary to obtain an opinion or ruling from the Minister. Industry Canada is most co-operative but insists on full disclosure of all relevant facts so the cautious investor seldom seeks such an opinion or ruling except as a last resort.

### **3.15 Review Procedure**

#### **(1) Application**

If an investment is reviewable, an application for review with the applicable information must be filed with Industry Canada prior to the investment taking place (or within 30 days of implementation of an indirect acquisition involving acquisition of control of a non-Canadian corporation) together with any other information or written undertakings the investor wishes to give. Industry Canada will assess the submissions and then report to the Minister who will determine whether the investment is likely to be of net benefit to Canada in accordance with the factors listed in Section 3.8.

#### **(2) Deemed Allowance**

Within 45 days after a complete application has been received, the investor must be notified that the Minister is either satisfied or is not satisfied that the investment is likely to be of net benefit to Canada. Alternatively, the investor may be notified that the Minister is unable to complete the review in which case the review period will be extended by 30 further days (or longer as agreed). Upon expiry of the applicable time period and unless the investor is otherwise notified the Minister is deemed to be satisfied that the investment is likely to be of net benefit to Canada and it is allowed to proceed.

#### **(3) Representations and Further Undertakings**

Where the investor is notified that the Minister is not satisfied that the investment is likely to be of net benefit to Canada he or she is entitled to make representations and to give undertakings within 30 days (or longer as agreed) of the Minister's notice. Upon expiry of the applicable time period the Minister must send a notice to the investor stating that the net benefit test has or has not been satisfied. If the net benefit test is not satisfied the investment is not to be implemented and if it has already been implemented, control is to be divested.

#### **(4) Planning for Review**

In the event that a review is required a detailed description of the plans of the non-Canadian for the operation of the new or acquired business is vital since the plans of the business will largely determine whether or not the investment will result in a net benefit to Canada. Accordingly, from the earliest stages of the planning process the necessity for review should be taken into account and the plans formulated with a view to presentation to Industry Canada in a manner which will reveal and highlight the nature and extent of benefits to accrue to Canada. Prior to making a formal application for review, it is suggested that (particularly in sensitive cases) consultation with representatives of the province affected by the investment is both necessary and desirable.

### **3.16 Penalties for Contravening the ICA**

Where a non-Canadian contravenes the provisions of the ICA the Minister may send a demand to either cease the contravention or remedy the default. If the non-Canadian has failed to comply with the demand, an application may be brought on behalf of the Minister to a superior court for such order as the circumstances require, including directing the non-Canadian to divest control of the Canadian business, suspending the non-Canadian's right to exercise voting interests or directing the non-Canadian to comply with a written undertaking. The court may also impose a monetary penalty against the non-Canadian not exceeding \$10,000 for each day the non-Canadian is in contravention of the ICA. Under NAFTA the sanction of requiring an investor to dispose of an investment where Americans or Mexicans are involved has been limited.

Although the only offenses specified in the ICA are for knowingly providing false or misleading information and for contravention of the privilege provisions, the commercial sanctions discussed above appear to be adequate to deter wilful contravention of the ICA.

### **3.17 Confidentiality**

Potential non-Canadian investors should be aware that all information obtained by the Minister or an officer or employee of the federal government in the course of administering the ICA is required to be kept strictly confidential under the privilege provisions of the ICA. Nevertheless, it would be prudent for the non-resident investor to file only such information as is necessary and to avoid gratuitously supplying additional facts.

### **3.18 Assessment**

Experience with the ICA since 1985 demonstrates that it has substantially reduced bureaucratic interference in the business activities of non-Canadians. The notification provisions of the ICA apply to approximately 94% of the investments which were formerly subject to review under the *Foreign Investment Review Act* (Canada). This results in relatively few investors being subject to the review process and those investments which are reviewable are usually processed by Industry Canada with a minimum of difficulty or delay. Furthermore, the amendments to the ICA made pursuant to NAFTA and the 1995 Amendments dealing with WTO investors substantially reduce the burden on these investors to comply with the ICA. In those cases where review is necessary, investors who have developed comprehensive plans formulated with an awareness of the factors to be taken into account in assessing net benefit to Canada can approach the review process with reasonable confidence. The investor is entitled to a decision within a maximum period of 75 days and can usually obtain a decision in less time if necessary.

Our experience under the ICA confirms that although the review process is a little bureaucratic, it is approached with a positive attitude by the responsible officials and applications are processed in a straightforward and expeditious fashion, with decisions being arrived at within the time limits specified. In our view, most non-resident investments in Canada will not encounter any insurmountable difficulties under the ICA and will receive a decision within a reasonable period of time after all relevant material is filed with Industry Canada.

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