DECEMBER 2004

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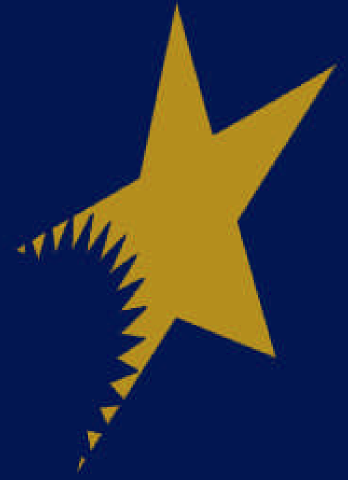
BARRISTERS & SOLICITORS LLP



Blaneys on Business

"As Canadian businesses grow in international scope, the need to carry them on exclusively in Canada diminishes. When it is not necessary to carry on these businesses in Canada, an offshore structure can be a great benefit."

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Alex Mesbur at 416.593.3949 or amesbur@blaney.com.

WE'RE MOVING

As of December 20, 2004 our new address will be:

Maritime Life Tower
2 Queen Street East
Suite 1500
Toronto, Canada
M5C 3G5

Our telephone numbers and e-mail addresses will remain the same.

MANY CANADIAN COMPANIES IN POSITION TO REDUCE TAX BURDEN

Paul Schnier

Many Canadian companies don't know it, but they are in a position to reduce their tax burden substantially.

As Canadian businesses grow in international scope, the need to carry them on exclusively in Canada diminishes. When it is not necessary to carry on these businesses in Canada, an offshore structure can be a great benefit.

By way of background, if a business were carried on in Ontario through a Canadian corporation, it would be subject to tax of approximately 18% on its first $300,000 of annual income and approximately 36% on the balance. Further tax would be paid when the shareholders withdrew the company's income, after corporate tax, in the form of dividends.

However, Canada has an international tax regime and treaty network that allows businesses to establish themselves in certain foreign countries (including so-called tax havens) in order to lower their overall rate of corporate tax.

These countries include Barbados, Cyprus, Luxembourg, The Netherlands and Switzerland. The Canadian policy that allows Canadian-owned businesses to operate in these jurisdictions at lower tax rates is a key part of Canada's effort to support the global competitiveness of Canadian multinationals.

Barbados offers one good example of a system that allows Canadian owned enterprises to operate at lower tax rates. The key instrument in Barbados is its International Business Corporation (IBC) legislation

The typical structure is for the Canadian company to carry on business through a corporation incorporated under the Barbados IBC legislation. The shareholder of the Barbados corporation is the Canadian corporation. The majority of the board of directors of the Barbados corporation would be residents of Barbados, as would its senior officers. As the sole shareholder of the Barbadian IBC, the Canadian corporation, through its directors, may set policy for the IBC but may not manage its day-to-day affairs. This management must be entrusted to the officers of the IBC, who are residents of Barbados.

The effect of this structure is that the income earned in Barbados by the IBC will be subject to corporate tax at a rate of about 1.5%. There will be no further tax when dividends are paid by the IBC to its Canadian corporate shareholder. Under the Canadian international tax system, these after-tax profits are not subject to further tax in the Canadian corporation. They are subject to Canadian tax only when the shareholders withdraw these profits in the form of dividends. The effect is a significant reduction in the overall rate of corporate tax as well as a deferral of virtually all tax until the money ultimately ends up in the hands of the shareholders.

As an example, if the annual income of the Barbadian IBC were $1,000,000, it would pay

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Paul Schnier chairs Blaney McMurtry's tax group. He restricts his practice to income tax law with emphasis on tax planning and implementation and advising as to the tax consequences of proposed transactions. He has advised a variety of public and private corporations on numerous domestic and international undertakings.

Paul can be reached at 416.593.3956 or pschnier@blaney.com.

$15,000 in tax compared to the $306,000 that would be paid if the business were being carried on in Canada through a Canadian corporation.

If the balances were paid out to Canadian owners in dividends taxed at an average rate of 30 per cent, those owners would be left with $689,500 in their pockets through the IBC vs. $485,800 through a Canadian corporation carrying on the business in Canada

There are two essential factors necessary for this structure to work:

1. The income must be earned by the Barbados IBC from activities conducted by the IBC in Barbados. In other words, even though clients may be international in scope, the business activities of the company must be conducted in Barbados; and
2. The management of these activities may not be attributed to Canada. Under the tax doctrine of "central management and control," if it were determined that the decision making for the IBC was taking place in Canada, the IBC would be deemed to be resident in Canada and subject to full Canadian corporate tax. It is essential therefore that the substance of the business activity follows the corporate form and that the structure is not merely a facade.

The planning for this type of structure, which many Canadian corporations employ successfully, is much more complicated than this article might suggest, but the benefits may be well worth it. ■

CONFIDENTIALITY AGREEMENTS CAN CREATE UNINTENDED PITFALLS IN BUSINESS, 'ETHICAL BARRIERS' MAY HELP AVOID THEM

Rodney L.K. Smith

When business people begin negotiating a joint venture or the purchase of another business, a piece of commercial real estate, or some other asset, a confidentiality agreement is often signed.

These agreements, designed to maintain the confidentiality of trade secrets or other sensitive business information, can end up creating unintended pitfalls in the conduct of ordinary business long after the negotiations that spawned them have concluded.

As an Ontario Court of Appeal decision demonstrates, a firm can organize and manage its affairs in ways that meet the confidentiality obligations it has undertaken and, at the same time, allow it to get on with the full range of activity in its day-to-day business life.

In the Court of Appeal case of *379107 Ontario Ltd. v. Coinamatic Canada Inc.,* the parties were competitors in the business of supplying coin-operated laundry machines to apartment buildings, paying the building owners a leasing fee for the laundry room and keeping the revenue generated by the use of the machines.

They entered into negotiations to explore the purchase of one by the other. In the course of these discussions, the potential seller provided a list of leases (without landlord or building locations) to allow the potential buyer to determine the price to be paid.

The buyer agreed that the information would be used only so that it could come up with a price that it would be prepared to pay and not so that it could compete with the seller.

The parties did not reach an agreement on a sale.

Subsequently, the potential buyer entered into a contract with one of the apartment owners whose leases were recorded on the list that had been used to calculate the offering price. The leases in question had expired. A lawsuit followed.

The trial judge accepted the evidence of the buyer that its sales department had pursued the leasing opportunity without any knowledge of the business purchase discussions taking place at an executive level.

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"These (confidentiality) agreements...can end up creating unintended pitfalls in the conduct of ordinary business long after the negotiations that spawned them have concluded."

Rodney L. K. Smith, Q.C. was, until very recently, chair of Blaney's commercial and general litigation group. He has a wide-ranging practice in corporate, commercial, insurance and municipal litigation.

Rodney can be reached at 416.593.3963 or rsmith@blaney.com.

When a sales report was made to one of the executives, he stopped the report and immediately established a so-called Chinese wall between the two groups within the company. (Chinese walls, or ethical barriers as they are coming to be known, are set up within an organization to prohibit the flow of confidential information from one group within it to the others. Chinese walls are typically put in place to deal with conflicts of interest or potential conflicts of interest.)

The trial judge concluded that the potential buyer acquired the leases without making any use of confidential information and accordingly was not in breach of its undertaking.

Confidentiality agreements can be simple or complex and many issues can come up in relation to them. These would include, for example, questions of what is confidential information, questions as to whether confidential information was used and, if used, whether the use was permitted nevertheless.

Another potential issue is the duration of the confidentiality agreement and how long the confidential information is protected. For confidential information to be protected, the law does not require that there be a confidentiality agreement. There is a common law duty of confidentiality. Even so, parties are well advised to make use of a written agreement.

What business people must be alert to is the conflicts that can arise when confidential information is obtained during negotiations between two parties that have a competitive or potentially competitive relationship.

Generally, the duty of confidentiality extends long after the confidentiality agreement has been signed and the related negotiations have been terminated. Where the parties are in an actual or potentially competitive situation, care must be taken to ensure that the party receiving the confidential information does not unwittingly, through the activities of other departments within the company, run afoul of the confidentiality provisions. ■

COPYRIGHT LAW CHANGES IMPACTING ON RIGHTS OF CREATORS, USERS

Steven L. Nemetz

Canadian copyright law is changing in ways that promise to have an impact on the people and corporations that create, and use, works of intellect and the arts.

This change is flowing from recent decisions of the Supreme Court of Canada. The Court recently described the *Copyright Act* as providing "a balance" between the rights of those who create works of the arts and the intellect – *Copyright Creators/Owners* – and those who wish to use such works – *Copyright Users*. By its recent decisions in this area of the law, however, the Court appears to have tipped the balance in favor of copyright users.

In *The Law Society of Upper Canada v. CCH Canadian et al.*, the plaintiffs, a group of legal publishers, sought to restrain the defendant, the governing body of Ontario's law profession, from providing certain photocopying services to lawyers in Ontario through the law library which the Law Society operated.

At issue was a custom photocopy service provided by the Law Society's Great Library at Osgoode Hall in Toronto which faxed single copies of materials to lawyers on request. The library also provided free-standing photocopiers in its library for the users of the library. There were two key issues. One, was there copyright in the publishers' legal publications? Two, did the photocopying services infringe the publishers' copyright or were these activities permitted

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Steven L. Nemetz is an intellectual property lawyer and a member of Blaney McMurtry's corporate/commercial practice. He was called to the Bar of Ontario in 1983. A Master of Laws in intellectual property law from Osgoode Hall Law School, he is a registered Trade-mark agent, a fellow of the Intellectual Property Institute of Canada, the International Trademark Association, the Copyright Society of the U.S.A., and the Licensing Executives Society. Mr. Nemetz is a past Co-Chair of the Entertainment, Media & Communications Section of the Ontario Bar Association and a member of the executive of the Information Technology and E-Commerce Section of the Ontario Bar Association.

Steven can be reached at 416.593.3958 or snemetz@blaney.com.

under Canada's fair dealing exception to copyright infringement?

(The fair dealing exception is the exception to the general rule that you cannot copy another's work without their permission. Historically, this exception has been taken to apply narrowly to such excepted activities as private study and research for non-commercial purposes.)

The Supreme Court found that the plaintiffs held copyright in the head notes, case summaries, topical indexes and compilations of reported judicial decisions that they published.

The Court clarified the degree of originality required to establish copyright as requiring that the work originate with the author.

In addition, the Court required that there be something more than the traditional requirement of the author having exerted energy in order to establish copyright in a created work. This traditional requirement has been referred to as the "sweat of the brow" approach established in the older English legal decisions.

The Court, however, did not go so far as to require a "modicum of creativity" as required by the Supreme Court of the United States. The Canadian test for originality required to establish copyright is now accordingly somewhere in the middle ground between the English and U.S. test for "originality. That is, the Canadian test requires that the copyrightable work be the product of the "exercise of skill and judgment" that would necessarily involve intellectual effort.

The Court found that the Law Society did not authorize copyright infringement by providing self-service photocopiers in its library. The Court also found the Law Society was protected by the "fair dealing" provisions of the *Copyright Act*, which exempted activities carried on for the purposes of research or private study from infringement.

In the Court's view the "research" exception to copyright infringement must be given a large and liberal interpretation and is not limited to non-commercial or private contexts. Accordingly, even lawyers may be found to be conducting activities that may be exempt from copyright infringement when related to "research," though they conduct research in connection with the business of law for profit.

However, perhaps the most resounding note in this decision is the Court's comment that the *Copyright Act's* exceptions to copyright infringement need not be construed narrowly. "User rights are not just loopholes". Both owner rights and user rights should therefore be given a fair and balanced reading.

Since nowhere does the Copyright Act make reference to "user rights," the Court's introduction of this new language clearly tips the balance. Previously narrow exceptions to copyright infringement have now been elevated to "user rights".

All stakeholders in the copyright arena should take note of the changing level of the playing field, when it comes to Copyright Law in Canada, for the implications these changes will have on their rights and their existing arrangements relating to property which is subject to copyright. ■

Blaneys on Business is a publication of the Business Law Department 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 Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com.Legal questions should be addressed to the specified author.

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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

20 Queen St. West, Suite 1400
Toronto, Canada M5H 2V3
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com