Foreign investment in Canada is regulated by the federal *Investment Canada Act* (ICA). Its purpose is to encourage foreign investment on terms that are beneficial to Canada.

While the ICA is primarily administered by Industry Canada, the Department of Canadian Heritage administers the Act in relation to defined “cultural businesses,” which is discussed later in this chapter.
In general, the acquisition of control of an existing Canadian business or the establishment of a new Canadian business by a foreign investor is subject to notification or review.

Notification involves the completion of a prescribed form to provide certain information about the foreign investor, the Canadian business and the vendor. It is not an impediment to the closing of an acquisition — in fact, it can be submitted within 30 days of closing and is usually submitted after closing.

Where review is required, the foreign investor must submit more detailed information about itself and comprehensive plans for the Canadian business before closing. Where review is necessary, the foreign investor may only complete the proposed investment if the minister of industry or the minister of Canadian heritage, as applicable, determines it to be of "net benefit to Canada."

Whether the investment is reviewable, or merely notifiable, depends on a combination of the following factors:

- The enterprise value of the target Canadian business
- Whether the investor is controlled by residents of a World Trade Organization member state (a "WTO investor")
- Whether the investor is a state-owned enterprise (SOE)
- The value of the assets of the target Canadian business
- Whether the target Canadian business is already foreign controlled by a non-Canadian WTO investor
- Whether the Canadian target carries on a defined cultural business
- Whether the investment is to be effected directly, through the acquisition of a Canadian business, or indirectly, through the acquisition of a foreign business of which the Canadian business is a subsidiary

Certain transactions involving foreign investors are exempt from the provisions of the ICA, including internal corporate reorganizations that involve no change of ultimate control, realization of security held by a foreign entity on Canadian assets, bona fide estate transfers, and acquisitions of control of Canadian businesses subject to review under other Canadian legislation, such as the Bank Act (Canada).

1. CANADIAN BUSINESS
   A business is deemed Canadian when it has:
   - A place of business in Canada
   - One or more individuals in Canada who are employed in connection with (but not necessarily by) the business
   - Assets in Canada that are used to carry on the business

2. FOREIGN INVESTOR
   A foreign investor is essentially a non-Canadian.
   With respect to individuals, a Canadian is a Canadian citizen or, subject to certain qualifications, a permanent resident of Canada within the meaning of Canada's immigration legislation.
   With respect to a business undertaking — including one owned by a government — the undertaking is considered Canadian if it is Canadian-controlled. Provisions relating to Canadian control are detailed and complex, but generally:
   - If one Canadian, or two or more Canadian members of a voting group, owns a majority of the voting interests of an entity, the entity is Canadian-controlled.
   - Conversely, if one non-Canadian, or two or more non-Canadian members of a voting group, owns a majority of the voting interests of an entity, the entity is not Canadian-controlled.
   - With respect to a widely held public company that is not controlled in fact through the ownership of voting shares, the corporation is deemed to be Canadian-controlled if at least two-thirds of the board of directors is Canadian.

3. ACQUISITION OF CONTROL
   The ICA contains detailed and complex provisions relating to the acquisition of control of a Canadian business by a foreign investor. To summarize:
   - The acquisition of a majority of a corporation’s voting shares is deemed to be an acquisition of control.
   - The acquisition of less than a majority, but more than one-third, of a corporation’s voting shares is considered an acquisition of control — unless it can be established that the acquiring party will not have control in fact of the corporation. For example, a 40 per cent acquisition would not result in control if another shareholder owned
the remaining 60 per cent, and a shareholders’ agreement limiting the larger shareholder's rights did not exist.

- The acquisition of less than one-third of a corporation’s voting shares is deemed to not be an acquisition of control.

4. REVIEW THRESHOLDS

Thresholds differ depending on the characteristics of the investor and the investment in question. If the review thresholds are not exceeded, the investment is subject to the notification procedure previously described.

a. Private sector WTO investors

i. Direct investment by a WTO investor that is not an SOE in a non-cultural Canadian business

The proposed direct acquisition of control of a Canadian business by a WTO investor that is not an SOE is reviewable if the enterprise value of the Canadian business exceeds $600 million.1 In our experience, this is by far the most common permutation of foreign investment.

The formula for determining the enterprise value (EV) varies depending on whether the foreign investor is acquiring shares of a publicly traded company, 100 per cent of the shares of a private company, less than 100 per cent but more than a controlling number of shares of a private company, or assets.

**IN SUMMARY:**

- **EV of publicly traded company =** market capitalization + liabilities other than operating liabilities – cash and cash equivalents.

  Market capitalization is based on the average closing price of the target’s quoted equity securities in its principal market during the 20 trading days ending before the first day of the month immediately preceding the month in which the foreign investor submits its Application for Review or Notification Form.

- **EV of private company =** acquisition value + liabilities other than operating liabilities – cash and cash equivalents.

- **EV of assets =** acquisition value + liabilities assumed by the investor other than operating liabilities – cash and cash equivalents.

In the following situations, the board of directors or other authorized body of the foreign investor are required to determine the fair market value of the applicable item for inclusion into the balance of the applicable enterprise value formula:

- Where not all of a public company’s equity securities are quoted

- Where the acquisition value cannot be precisely determined until a future date (e.g., there is an earn out or some other form of post-closing adjustment)

- Where the foreign investor is acquiring less than 100 per cent of the shares of a private company

- Where the parties are non-arms-length or the consideration is nominal or zero

ii. Direct investment by a WTO investor in a Canadian cultural business

The proposed direct acquisition of control of a Canadian cultural business is reviewable if the book value of the assets of the Canadian business exceeds $5 million. The same threshold applies if the investor is a non-WTO investor and/or an SOE.

Cultural businesses include:

- The publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine-readable form, but not including the sole activity of printing or typesetting books, magazines, periodicals or newspapers

- The production, distribution, sale or exhibition of film or video recordings

- The production, distribution, sale or exhibition of audio or video music recordings

- The publication, distribution or sale of music in print or machine-readable form

- Radio communications in which the transmissions are intended for direct reception by the general public; any radio, television and cable television broadcasting undertakings; and any satellite programming and broadcast network services

The ICA does not provide an exemption for de minimis involvement in a cultural business. Thus, even if a Canadian business is primarily involved in non-cultural business activities, a minimal involvement in cultural business activities will trigger the review obligation if the $5-million threshold is exceeded.

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1 This threshold will increase to $800 million on April 24, 2017, and will increase to $1 billion on April 24, 2019. Starting on January 1, 2021, it will be adjusted annually based on the growth in Canada’s GDP.
When review is required for a proposed acquisition of a Canadian business that involves both non-cultural and cultural business activities, applications for review must be submitted to Industry Canada (with respect to the non-cultural aspects of the business) and the Department of Canadian Heritage (with respect to the cultural aspects of the business).

iii. Indirect investment by a WTO investor in a non-cultural Canadian business

Indirect acquisitions of control by WTO resident investors are not reviewable unless they involve the acquisition of a Canadian cultural business, in which case the $5-million threshold applies. The same applies to WTO investors that are SOEs.

It should be noted that structuring a transaction for the purpose of avoiding review — e.g., incorporating a corporation outside of Canada, the sole assets of which are the shares of the Canadian corporation, and then purchasing the shares of the foreign corporation — is not permissible.

b. Private sector non-WTO investors

i. Direct investment by a non-WTO investor in a Canadian business

The proposed direct acquisition of control of a Canadian business by an investor that is not a WTO investor is reviewable if the book value of the assets of the Canadian business — as stated on its financial statements at the end of its most recently completed fiscal year — exceeds $5 million,
regardless of whether the Canadian business is engaged in non-cultural or cultural business activities, or whether the investor is also an SOE.

ii. Direct investment by a non-WTO investor that is not an SOE in a Canadian business, where the Canadian business is already foreign controlled by a WTO investor

In this scenario, the threshold set out in section a.(i) applies.

iii. Indirect investment by a non-WTO investor

The proposed indirect acquisition of control of a Canadian business by an investor that is not a WTO investor is reviewable if:

- The book value of the assets of the Canadian business exceeds $50 million
- The book value of the assets of the Canadian business exceeds $5 million, and the value of the assets of the Canadian business represents more than 50 per cent of the value of the assets of the target’s entire international business

As with indirect acquisitions of control by WTO investor, the $5-million threshold also applies if the Canadian business is engaged in cultural business activities.

c. SOE investors

i. Direct investment by a WTO investor that is an SOE in a non-cultural Canadian business

The proposed direct acquisition of control of a Canadian business by a WTO investor that is also an SOE is reviewable if the book value of the assets of the Canadian business — as stated on its financial statements at the end of its most recently completed fiscal year — exceeds $375 million.2 The lower $5-million threshold applies if the Canadian business is engaged in cultural business activities.

In some cases, it may be difficult to determine whether a foreign investor is an SOE and, by extension, which threshold applies. This is because the Act’s definition of SOE includes an entity that is “controlled or influenced, directly or indirectly” by the government of a foreign state, whether federal, state or local, or an agency of such a government.

ii. Direct investment by a non-WTO investor that is also an SOE in a non-cultural Canadian business where the Canadian business is already foreign controlled by a WTO investor

In this scenario, the threshold set out in section c.(i) applies.

iii. Indirect investment by an SOE

If the SOE is a WTO investor, the acquisition of control of the Canadian business is not reviewable — see section a.(iii) for further details. If the SOE is not a WTO investor, the threshold set out in b.(iii) applies. In either case, if the Canadian business is engaged in cultural business, the $5-million book value of assets threshold applies.

d. Discretionary powers

In addition to reviews that result from the application of the aforementioned rules, the government has other discretionary powers to order a review. For example:

- The government can review any investment that “could be injurious to national security.”
- The government can deem that an entity is an SOE in fact, or deem that there has been an acquisition of control.
- With respect to most types of cultural businesses, the government can:
  › Elect to review the acquisition of control of an existing business or the establishment of a new Canadian business within 21 days of receiving the foreign investor’s notification
  › Deem a business that carries on, or proposes to carry on, any such business to be non-Canadian on the basis that the business is controlled in fact by one or more non-Canadians

5. REVIEW

Where review is required, the foreign investor must submit an Application for Review and may not complete the proposed investment until the minister of industry and/or minister of Canadian heritage, as applicable, has determined it to be of “net benefit to Canada.”

In the application, detailed information is required about the foreign investor, the Canadian business and the foreign investor’s plans for the Canadian business.

To determine whether the proposed investment is likely to be of net benefit to Canada, the government considers factors such as:

- The effect of the investment on the level and nature of economic activity in Canada, including its effect on

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2 The figure of $375 million applies in 2016, up from $369 million in 2015. It is adjusted annually based on the change in Canada’s GDP.
employment, resource processing, the utilization of parts, components and services produced in Canada, and exports from Canada

- The degree and significance of participation by Canadians in the business
- The effect on productivity, industrial efficiency, technological development, product innovation and product variety in Canada
- The effect on competition within any industry in Canada
- Compatibility with national industrial, economic and cultural policies
- Its contribution to Canada's ability to compete in world markets

In considering these factors, the minister of industry or the minister of Canadian heritage, or both as applicable, will consult with other relevant federal government departments as well as the governments of affected provinces, which are typically provinces in which the Canadian business has assets or employees.

A determination of net benefit to Canada is usually based on undertakings made by the foreign investor in relation to the factors outlined above. Undertakings are legally binding commitments made by a foreign investor that typically remain in effect for three to five years, and are subject to compliance reviews and audits over that time.

In our experience, the government is most concerned with securing undertakings that relate to specific levels of employment in Canada, the inclusion of Canadians in management positions, capital investment in the Canadian business and further development of Canadian-sourced technology in the country. However, the specific focus of the undertakings varies depending on the nature of the business.

b. Possible outcomes

The government may either approve the proposed investment or reject it. Almost all proposed investments are ultimately approved based on undertakings negotiated between the investor and the government. Only a handful of high-profile and/or politically controversial transactions have been rejected. For transactions that could raise significant political concerns, foreign investors should not underestimate the importance of an effective government relations strategy.

c. Fee

There is no filing fee for either an Application for Review or a Notification.

6. NATIONAL SECURITY

In 2009, the ICA was amended to provide the government with the right to review any investment that “could be injurious to national security.” In 2013, and again in 2015, the government amended the national security provisions to provide itself with additional flexibility in relation to national security matters. This right to review applies to minority investments, internal reorganizations and the establishment of new Canadian businesses, not just the acquisition of control of existing Canadian businesses. It can also apply to investments in businesses with tenuous links to Canada, as a review can be ordered if “any part” of the business’ operations are in Canada.

There is no minimum investment size below which a review on national security grounds may not be ordered. The government has deliberately provided no guidance as to what kind of investment could constitute a threat to national security, affording itself maximum flexibility to take a “we’ll know it when we see it approach.” The national security provision empowers the government to prohibit any proposed investment, impose conditions on its completion, or require divestiture of a completed investment. A national security review can take up to 200 days.

Full or even substantial information on the government’s use of the national security powers is not public. However, the government recently, for the first time, released certain high-level information on its use of the power. Eight national security reviews have been conducted since the powers were introduced in 2009. In three of these cases, the government prohibited the foreign investor from completing the transaction (i.e., where the government conducted its review
before the closing of the transaction). In two cases, the government required the foreign investor to divest the Canadian business (i.e., where the government conducted its review after the closing of the transaction). In two cases, it allowed the transaction to close subject to conditions (which the government has not disclosed), and in another case, the parties abandoned the transaction. Notably, the government has not disclosed the industries in which the relevant Canadian businesses operated, the country of origin of the relevant foreign investors, or whether the relevant foreign investors were SEOs.

One of the biggest risks to foreign investors posed by the national security review powers relates to transactions that do not exceed the applicable mandatory review threshold. These transactions can be completed before being notified, as it is possible that the government could conduct a review and order divestiture after closing, which we now know has already happened in two cases. The government may not commence a national security-related review more than 50 days after receiving an investor’s notification — 45 days plus a five-day notice period.

To address this risk in the context of transactions that could possibly raise national security review concerns due to the nature of the acquired Canadian business and/or the foreign investor, the investor can submit a notification more than 50 days before closing, and include a closing condition in the purchase agreement that either no national security review shall have been commenced, or any such review that is commenced shall have been concluded on terms satisfactory to the investor.

7. STATE-OWNED ENTERPRISES

In 2007, the government issued guidelines to clarify how the “net benefit to Canada” test will be applied in the context of proposed investments by foreign SEOs. The government subsequently provided additional guidance with respect to the application of the net benefit to Canada test, and amended various provisions of the ICA in relation to SOEs.

Essentially, the purpose of the guidelines is to ensure that the acquired Canadian business will continue to be operated on a commercial basis, with transparent corporate governance and reporting requirements, rather than to serve the non-commercial, political objectives of a foreign state. The purpose of the amendments is to subject SOE purchasers to a lower review threshold than non-SOE purchasers.

8. SECTOR-SPECIFIC LEGISLATION

In addition to the general ICA process, various federal and provincial statutes place additional restrictions on foreign ownership in specific industries.

Learn more about our services in this area at gowlingwlg.com/international-trade-canada