CANADIAN INTERNATIONAL TAX DEVELOPMENTS

SPEAKERS:

Nik Diksic, EY Law LLP, Montreal

Mark Dumalski, Deloitte LLP, Ottawa

Jennifer Hanna, Borden Ladner Gervais LLP, Calgary

MODERATOR:

Olivier Labelle, Deloitte LLP, Calgary

AGENDA

1. Legislative Updates
2. OECD BEPS 2.0
3. GAAR
4. Questions

LEGISLATIVE UPDATES

FROM APRIL 2022 TO PRESENT

CFAs of CCPCs / Substantive CCPCs

- Relevant Tax Factor changed from 4 to 1.9
  - FAPI is no longer your friend
- FAPI vs. 125(7) "specified investment business"
  - FAPI much broader than Aggregate Investment Income
- CDA
  - Additions for repatriated non-taxable half of hybrid surplus and dividends to the extent foreign tax paid at rate of at least 52.63%
  - No relief for non-taxable half of capital gains other than hybrid surplus (e.g. investment portfolio gains, real estate)

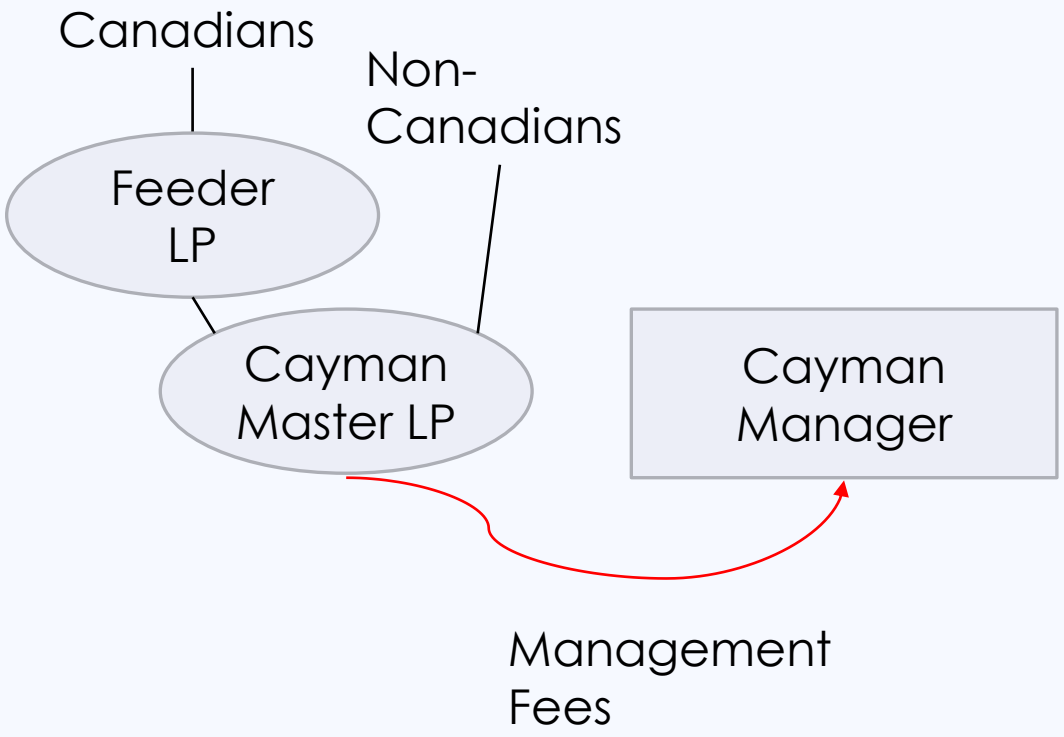
Foreign affiliate share exchanges and foreign mergers

- 85.1 and 87.3
- Expansion of rules restricting exchanges involving FAs
- Proposals overreach – Joint Committee

Partnerships and Part XIII

- 212(13.1)(a) – Partnership required to withhold on payments to the extent that the payment is deductible in computing the Canadian taxable income of a partner
  - E.g. foreign fund pays management fee to Cayman manager and there is a Canadian partner who is subject to Part I tax
  - To be abandoned?
- 212(13.2) – Non-resident withholding obligation in respect of amounts paid to a non-resident that are deductible by payer NR in computing Canadian-source income that is not treaty-protected.
  - Now includes payments deductible in computing s.216 income (rental income) and payments made to partnerships other than Canadian partnerships.
- 212(13.1)(b) and 212(13.11) – Partnership supporting rules

Partnerships and Part XIII – 212(13.1)(a) & 212(13.11)



212(13.1)(a) – 25% withholding on portion of management fee that is deductible in computing Canadian members' taxable income

212(13.11) – lookthrough rule for tiered partnerships – members of Feeder deemed to be members of Master

Upstream and Shareholder Loans

- 15(2.3), 90(8)(b) – similar changes
- Exemption for financing companies no longer available, unless 90%+ arm's length lending
- Coming into force rule for 90(8)(b)?

Subsections (1) and (2) apply to loans made after 2022. Subsection (1), subsection 90(6) of the Act and all provisions of the Act relevant to the interpretation and application of subsection 90(6) of the Act also apply in respect of any portion of a particular loan made before 2023 that remains outstanding on January 1, 2023 – as if that portion were a separate loan that was made on January 1, 2023 in the same manner and on the same terms as the particular loan – if, at the time when the particular loan was made, it met the requirements of *subsection 90(6) of the Act as in force at the time when the particular loan was made*.

Odds and sods

- Functional Currency - Yen allowed as functional currency; tightened 261(18)(c) preventing retroactive planning via transfers between taxpayers with different functional currencies; stop-loss rule tightened
- 93.3 - India unit trusts added (formerly just Australian trusts)
- Consultations on transfer pricing rules (2021 budget), reconfirmed intention to consult in 2022 budget and 2023 budget
- Interest coupon stripping rules (announced in 2022 budget, enacted)
- Fixed circularity issue in "eligible controlled foreign affiliate" 95(4)
- FAD rules – tightened PUC reinstatement rule
- Budget 2023 re-confirms commitment to Hybrid Mismatch 2.0, Pillar 1 and Pillar 2

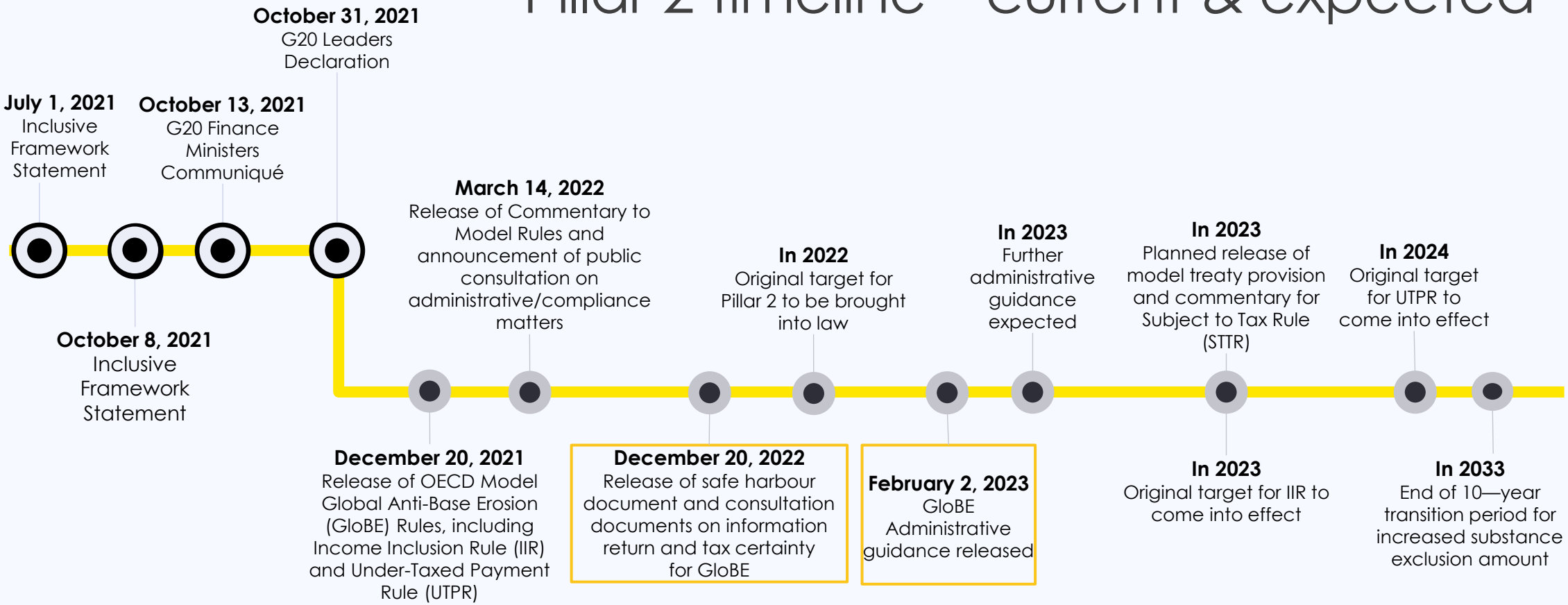
OECD BEPS 2.0

PILLAR 2 - RECENT DEVELOPMENTS

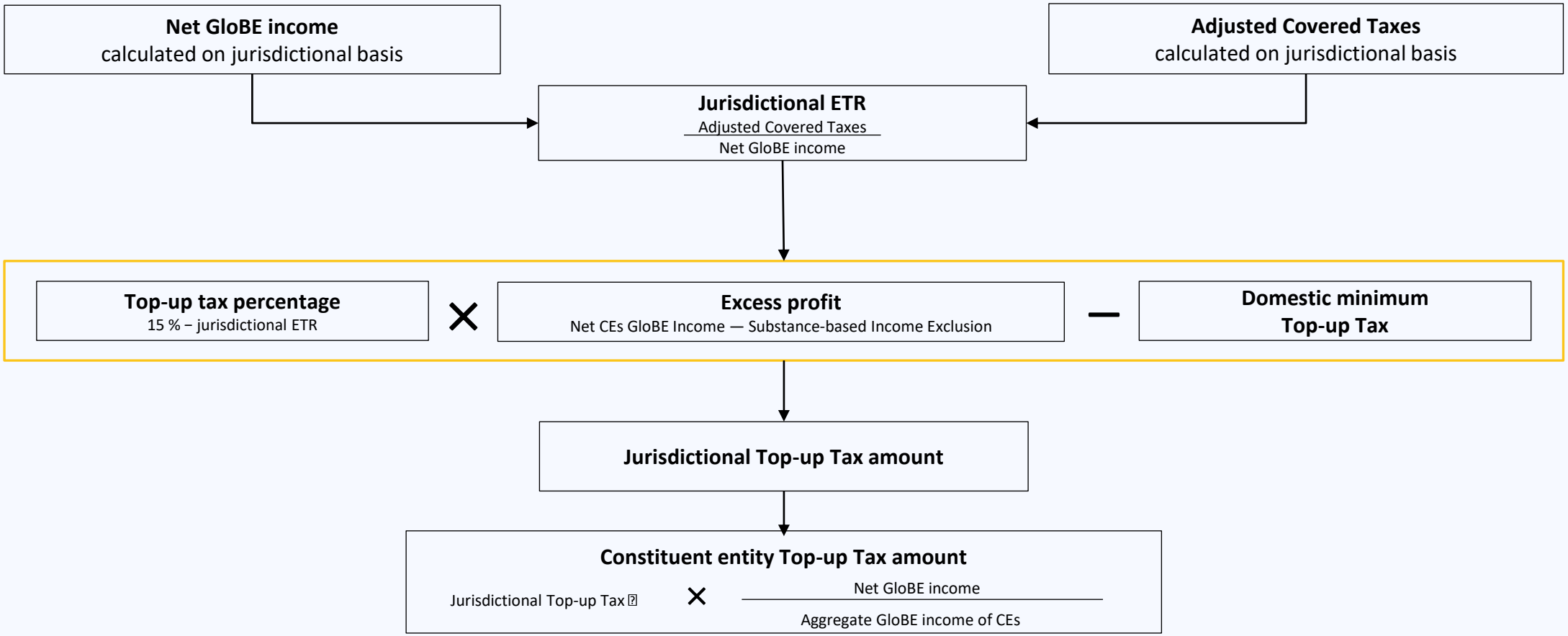
Pillar 2 - Summary

- Pillar 2 introduces **global minimum tax** mechanisms
- The 142 jurisdictions participating in the OECD/G20 Inclusive Framework have agreed on a new global minimum tax mechanism designed **to help ensure that all large multinational corporations pay at least 15% income tax in all countries of operation**
- A Global Anti-Base Erosion (GloBE) regime designed to help ensure all large internationally operating businesses pay at least a **minimum level of tax**
  - Minimum tax rate of **at least 15%**
  - Implemented via an Income Inclusion Rule (IRR), the primary rule, and an Undertaxed Profits Rule (UPR), the backstop rule
- A treaty-based Subject To Tax Rule (STTR) with **9% minimum tax rate —** first applicable rule with a withholding tax at source on certain type of intragroup payments (interest, royalties, etc.)

Pillar 2 timeline – current & expected



Pillar 2 – Simplified top-up tax calculation



Pillar 2 Safe Harbours and Penalty Relief

- Aims to simplify calculations and adjustments to financial income and taxes mandated by the Global Anti-Base Erosion Rules (GloBE Rules or Model Rules)
- Three main components:
  - Transitional CbCR Safe Harbor (TCSH)
  - Framework for development of Permanent Simplified Calculation Safe Harbor
  - Common understanding of Transitional Penalty Relief Regime (contingent on being included in local law)
- Potential further simplification of the Model Rules to be released in 2023
  - Qualified Domestic Minimum Top-up Tax (QDMTT) safe harbour that may eliminate the need to perform GloBE calculations for application of Income Inclusion Rule (IIR)/Undertaxed Payment Rule (UTPR) for jurisdictions that adopt a QDMTT regime
- Safe Harbors described above apply to QDMTT as well

Pillar 2 Transitional CbCR Safe Harbour (TCSH)

- Based on **Qualified CbCR Report** (needs to comply with TCSH requirements on sources of data, which are more stringent than normal CbCR requirements)
- The tests for the TCSH are applied on a jurisdictional basis and any one of the three tests can be applied for each jurisdiction
- **Once out, always out**: Once the TCSH is not applied to a jurisdiction for a fiscal year to which the GloBE Rules apply, it cannot be applied for a subsequent fiscal year
- May meet any one of the three tests described in the previous slide in a **transition year** (ie., all fiscal years beginning on or before 31 December 2026 but not including a fiscal year that ends after 30 June 2028) to qualify — no requirement to apply a single test consistently

De minimis test

- Total revenue of less than EUR 10m and
- Profit (loss) before income tax (PBT) of less than EUR 1m

Simplified ETR test

MNE Group's Simplified ETR in a jurisdiction (simplified covered taxes/PBT) must be equal to, or greater than the transition rate:

- 15% (2023–24)
- 16% (2025)
- 17% (2026)

Routine profits test

MNE Group's Profit (Loss) before Income Tax in a jurisdiction is equal to, or less than, the substance based income exclusion amount

Pillar 2 GloBE Information Return

- Consultation document released in December 2022

Who files?

- Each constituent entity (CE) located in a GloBE implementing jurisdiction is required to file a GloBE information return.
- CEs could be discharged from requirement if return is filed by:
  - The Ultimate Parent Entity (UPE) located in a jurisdiction that exchanges information with the CE's jurisdiction, or
  - By a Designated Filing Entity appointed by the MNE Group that exchanges information with the CE's jurisdiction
- This mechanism would allow filing of a single GloBE Information Return (GIR) covering all Constituent Entities in the MNE Group, through a reporting information process similar to that built for Country-by-Country Reporting (CbCR) exchange of information.

When to file?

- The GloBE Information Return and related notifications should be filed with the tax administration of the GloBE implementing jurisdiction no later than 15 months after the last day of the reporting fiscal year.
- For the first year that GloBE is in effect (the transition year), the return is due no later than 18 months after the last day of the reporting fiscal year.

Pillar 2 Tax Certainty Measures

Possible dispute prevention mechanisms

Agreement on model rules, commentary and future Administrative guidance creating alignment of jurisdictions' implementation of GloBE Rules

- Peer review process for qualified rule status
- Referral of questions to Inclusive Framework
- These approaches would deal with broad interpretation but not application in specific cases

Common risk assessment of coordinated compliance process

- Inclusion of GloBE issues in International Compliance Assurance Program (ICAP)
- Development of a GloBE-specific program

Advanced Pricing Agreement (APA) process

- Would require development of a common standard as reference
- Access to APAs not universal

Possible dispute resolution mechanisms

Basic elements

- MNE allowed to submit request
- Competent authority to resolve case with other relevant competent authorities
- Agreement to be implemented without regard to domestic time limits

Need to specify scope of disputes covered and basis for resolving them

Possible mechanisms

- Development of multilateral convention with respect to GloBE
- Use of convention on mutual administrative assistance in tax matters
- Use of existing tax treaties
- Creation of domestic law dispute resolution provisions

Pillar 2 Administrative Guidance

- Released by OECD on February 2, 2023 as approved by Inclusive Framework
- Described as addressing issues under the GloBE model rules (released December 20, 2021) and commentary (released March 14, 2022) that the Inclusive Framework identified as most in need of immediate clarification
  - Includes changes to existing rules contained in the previously released GloBE model rules and commentary
  - Structured as additions and other modifications to the commentary
- Covers the following topics
  - Transition rules
  - Qualified Domestic Minimum Top-up Taxes (QDMTTs)
  - Allocation of taxes under Blended CFC Tax Regime (i.e., US GILTI)
  - Application of GloBE Rules to insurance companies
  - Certain additional issues related to scope and income and taxes
- The Inclusive Framework is continuing to work on additional guidance

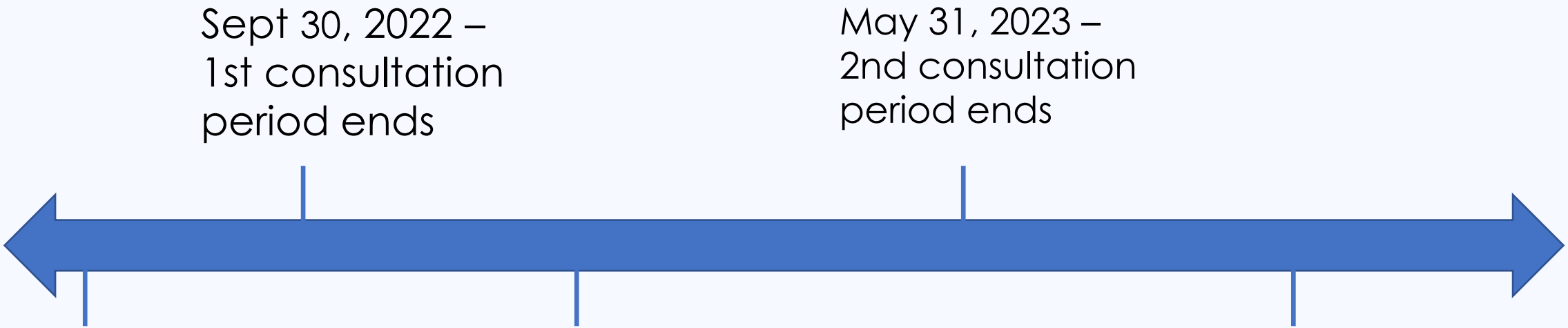
Pillar 2 in Canada

- Budget 2022 – public consultation on implementation of Pillar 2 model rules
- Budget 2023 - affirms Canada's intention to introduce legislation implementing the Pillar Two global minimum tax. IRR and QDMTT would be effective for fiscal years of multinational corporations that begin on or after December 31, 2023. UTPR would be effective for fiscal years that begin on or after December 31, 2024
  - Budget estimates increased tax revenues of $5.1B in first two years of implementation
  - Represents an approximate increase of 3% in corporate tax revenues
  - Revenues to be shared with provinces and territories
- Over 200 Canadian companies in scope
- Implementation of Model Rules
  - Priority for Department of Finance
  - Transposition or adaptation?
  - Changes to existing and proposed tax credits?
  - Changes to existing FA rules – broader participation exemption?

THE GAAR

RECENT DEVELOPMENTS

Timeline


Sept 30, 2022 – 1st consultation period ends
May 31, 2023 – 2nd consultation period ends
August 2022 – Consultation paper released
Mar 28, 2023 – Budget proposals released
Aug/Sept 2023 – 2nd Budget Implementation Act

Preamble

- Allows taxpayers to obtain tax benefits contemplated by the relevant provisions
- Strikes a balance between certainty and fairness
- Can apply whether a tax strategy is "foreseen"

Lehigh Cement Limited v. R., 2010 FCA 124

BACKGROUND

- The **FCA allowed the taxpayer's appeal** from a TCC finding of abusive tax avoidance, holding that **GAAR did not apply** to a series of transactions through which the taxpayer's interest payments on debt held by a related non-resident corporation were paid free of withholding tax to an arm's-length Belgian bank.
- The debt restructuring was carried out to access the **withholding tax exemption** for interest paid at arm's length on corporate debt formerly provided under subparagraph 212(1)(b)(vii).

Lehigh Cement - New GAAR Considerations

Allows taxpayers to obtain tax benefits contemplated by the relevant provisions

- "When Parliament adds an exemption to the Income Tax Act, even one as detailed and specific as subparagraph 212(1)(b)(vii), it cannot possibly describe every transaction within or without the intended scope of the exemption. Therefore, it is conceivable that a transaction may misuse a statutory exemption comprised of one or more bright line tests such as, in this case, the arm's length test and the 5 year test. However, the fact that an exemption may be claimed in an unforeseen or novel manner, as may have occurred in this case, does not necessarily mean that the claim is a misuse of the exemption. It follows that the Crown cannot discharge the burden of establishing that a transaction results in the misuse of an exemption merely by asserting that the transaction was not foreseen or that it exploits a previously unnoticed **legislative gap**. As I read Canada Trustco, the Crown must establish by evidence and reasoned argument that the **result of the impugned transaction is inconsistent with the purpose of the exemption**, determined on the basis of a textual, contextual and purposive interpretation of the exemption." - para. 37

Canada v. Alta Energy Luxembourg S.A.R.L., 2021 SCC 49

- Central issue was the **eligibility of a Luxembourg holding company for benefits under the Canada – Luxembourg treaty** (Treaty), and specifically, the availability of an exemption from Canadian taxation of capital gains realized in respect of shares (Alta Canada) that derived more than 50% of their value from real property used in the company's active business.
- The Minister of National Revenue of Canada applied the GAAR to deny the treaty exemption.
- Tax benefit and avoidance transaction were both conceded by the taxpayer, and thus the key question was **whether there had been a misuse or abuse of the provisions of the treaty**. More specifically, the question to be addressed was whether the outcome achieved by the taxpayer defeated the underlying rationale of the provisions relied upon, having regard to their object, spirit, and purpose.
- The TCC, and subsequently the FCA, both ruled in favour of the taxpayer.
- **The SCC, in a 6 to 3 majority, dismissed the Crown's appeal.**

Alta Energy - New GAAR Considerations

Strikes a balance between certainty and fairness

"We acknowledge that finding that a transaction structured to claim tax benefits from a treaty can be abusive when a resident lacks economic connections to the state of residence may produce more uncertainty than mechanically applying the words of the Treaty. However, Parliament struck the balance it considered proper between certainty and fairness to the tax system as a whole. The facts of this case are a patent example of a **sophisticated taxpayer** effecting a restructuring on the basis of **professional tax advice** to avoid Canadian tax. In such cases, the principle of **fairness ought not to be ignored**. As for the degree of uncertainty introduced by the GAAR, it is counterbalanced by the Crown's burden to show that the avoidance transactions frustrate the object, spirit or purpose of the provisions relied on by the taxpayer and by the fact that any doubt under the GAAR analysis is to be resolved in favour of the taxpayer (Canada Trustco, at para. 69). In this case, the abuse is clear. The evidence demonstrates that Alta Luxembourg had no genuine economic connections with Luxembourg as it was a mere conduit interposed in Luxembourg for residents of third-party states to avail themselves of a tax exemption under the Treaty. We agree with our colleague that the lack of any non-tax purpose, although relevant, does not on its own lead to the determination of abuse in this case. Rather, it is this lack of any genuine economic connection to Luxembourg that frustrates the rationale of the relevant provisions of the Treaty. The Crown has discharged its burden." – para 177 (Dissent)

Alta Energy - New GAAR Considerations

- Can apply whether a tax strategy is "foreseen"
  - "The GAAR was enacted to catch unforeseen tax strategies. However, [this] was not an **unforeseen tax strategy at the time of the Treaty**…" – para. 80.
  - "In this case, the absence of specific anti-avoidance provisions represents, however, an enlightening contextual and purposive element as it sheds light on the contracting states' intention. **This is not a case where Parliament did not or could not have foreseen the tax strategy employed by the taxpayer**. Options to remediate the situation were available and known by the parties, but they made deliberate choices to guard some benefits against conduit corporations and to leave others unguarded." – para. 82.

"Avoidance Transaction"

- Current: "undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit"
- Proposed: "it may reasonably be considered that one of the main purposes for undertaking or arranging the transaction was to obtain the tax benefit"
- Primary "foreign tax" or "commercial" purpose no longer sufficient to prevent "avoidance transaction" status
- Not intended to apply to transactions where tax was "simply a consideration"

Loblaw Financial Holdings Inc. v. The Queen, 2018 TCC 182

- The facts of this case involved the **taxpayer's Barbados resident FA** receiving capital from related parties in the form of equity and intercorporate loans and using such capital to **invest primarily in short-term debt securities of arm's length persons**, as well as certain intercorporate loans and loans to independent drivers distributing baked goods of the corporate group.
- The TCC found in favour of the taxpayer, and the finding in respect of the non-application of GAAR was not appealed to the FCA.

Loblaw - New GAAR Considerations

Avoidance Transaction

- "Primary" purpose vs "one of the main purposes"

Overall, I take from the evidence that the transactions were entered into for **three purposes**:

1. To make money for Loblaw Financial through an elaborate investment strategy using offshore money.
2. To do so in a low tax jurisdiction with a recognized international financial infrastructure.
3. To avoid FAPI.

Loblaw - New GAAR Considerations

I further conclude that the **first two objectives were bona fide commercial purposes** and outweighed the third objective, which I would categorize more as an advantageous fallout from the first two. I do not conclude that it was the driving force behind these transactions, though I also do not accept that it was irrelevant or not a factor. It would belie credulity to suppose a major Canadian organization with its own tax department and dozens of foreign affiliates would not be fully cognizant of the tax implications of FAPI, and being so aware, would not have its avoidance as an objective. Indeed, Mr. Mavrinac testified the business needed to be an active business, yet it was the development of the business that drove this, not FAPI. Also, the fact one objective was to find a low tax jurisdiction does not go to the tax benefit, which relates only to FAPI avoidance. The choice of Barbados due to its low tax regime may have been a tax objective but it was not a tax benefit avoidance objective as contemplated by the GAAR." - paras. 307 & 308

Economic Substance

- Legal form still determinative
- No requirement to ignore legal form and determine economic substance of transactions
- Significant lack of economic substance "Tends to," but "not always" indicate misuse or abuse
  - Analysis of object, spirit, and purpose of provisions still required
  - Rebuttable presumption?
  - Who has the burden of proof?

Economic Substance

- Factors indicating lack of economic substance include:
  - Potential for pre-tax profit?
  - Change in economic position (taking into account all non-arm's length parties)
  - Whether transaction is entirely or almost entirely tax-motivated

R. v. MIL (Investments) S.A., 2007 FCA 236

- The taxpayer, a resident of the Cayman Islands and wholly owned by an individual who was a resident of Monaco, owned shares of a Canadian mining company, the value of which had increased substantially and was primarily attributable to immovable property situated in Canada.
- Before selling most of those shares, **the taxpayer reduced its percentage interest** in Canco to slightly less than 10 percent **and continued into Luxembourg**, where the gain was exempt from domestic tax, and **claimed the exemption under Article 13(4) of the Canada-Luxembourg Treaty** by virtue of the fact that the shares did not form part of a "substantial interest" (as defined in the Treaty) in Canco, as the taxpayer's interest had been reduced to under 10%.
- The TCC and FCA both found in favour of the taxpayer.

MIL Investments – New GAAR Considerations

- **Economic Substance**
  - Significant lack of economic substance "tends to" indicate misuse or abuse
  - "It is clear that the Act intends to exempt non-residents from taxation on the gains from the disposition of treaty exempt property. It is also clear that under the terms of the Tax Treaty, the respondent's stake in DFR was treaty exempt property. **The appellant urged us** to look behind this textual compliance with the relevant provisions **to find an object or purpose whose abuse would justify our departure from the plain words** of the disposition. We are unable to find such an object or purpose." – para. 6

Univar Holdco Canada v. R., 2017 FCA 207

- The facts involved the **takeover of a Dutch public company, Univar NV, by an arm's-length non-resident private equity firm**. Univar NV indirectly carried on business in several countries, including Canada. The Canadian subsidiary, Univar Canada Ltd., was indirectly owned by a US corporation. The shares of Univar Canada Ltd. had a nominal ACB and PUC, and significant FMV, at the time of the takeover. The parties implemented **a series of transactions that resulted in the purchaser's ability to extract the accumulated corporate surplus in Univar Canada Ltd. free from Canadian withholding tax.**
- The series of transactions technically met all of the conditions for the application of the anti-avoidance rule in section 212.1, but were **designed to qualify for the exemption** (as it then read) to that rule set out **in subsection 212.1(4).**

Univar Holdco – Economic Substance

Significant lack of economic substance "tends to" indicate misuse or abuse

- "The first step in determining whether an avoidance transaction is abusive is to determine the object, spirit and purpose of the provisions that give rise to the tax benefit … The wording of section 212.1 and the alternative transactions described above illustrate a clear dividing line between an arm's length sale of shares and a non-arm's length sale of shares. … in my view, the purpose of section 212.1 of the ITA was not to prevent the removal from Canada, by an arm's length purchaser of a Canadian corporation, of any surplus that such Canadian corporation had accumulated prior to the acquisition of control." – para. 21

Univar Holdco – Economic Substance

- "In this case **the Minister has not clearly demonstrated** that the avoidance transaction completed in this case was abusive. The transactions were completed as part of an arm's length purchase of Univar NV. The purpose of the avoidance transaction was, in effect, to allow the arm's length purchaser to extract the surplus in the Canadian corporation that had accumulated prior to the acquisition of control without triggering any tax under Part XIII. There was an alternative means by which the same result could have been achieved without triggering any Part XIII tax if the shares of Univar Canada would have been sold to an arm's length purchaser and the Minister has not clearly demonstrated that the removal of surplus in an arm's length transaction would be abusive." – para. 31

The GAAR Penalty Regime

- Penalty equal to 25% of tax benefit
- Extension of statute barred period by 3 years
- Both measures negated through taxpayer disclosure
  - Mandatory / voluntary