International Fiscal Association

YIN SESSION CANADA

GLOBAL MINIMUM TAX ACT

SPEAKERS:
JOHN D. FARQUHAR, FELESKY FLYNN LLP, CALGARY
TIM FRASER, KPMG CANADA, VANCOUVER

MODERATOR:
EHSAN WAHIDIE, DELOITTE CANADA, TORONTO

PRESENTED ON JUNE 12, 2024 | CANADA

OUTLINE

1. Background to BEPS 2.0 Pillar 2
2. Introduction to the *Global Minimum Tax Act* (“**GMTA**”)
3. Scope of GMTA
4. Safe Harbours
5. DMTT Calculations – Select Considerations (with examples)
6. Takeaways

01
BACKGROUND TO BEPS 2.0 PILLAR 2

BACKGROUND TO BEPS 2.0 PILLAR 2

- OECD's Global Anti-Base Erosion Rules (GloBE Rules)
- Developed as part of OECD's BEPS Action Plan to address "challenges of the digital economy"
- Objective:
  - Disincentivize large MNE's from offshoring "mobile income" to low tax jurisdictions;
  - Disincentivize countries from using low or non-tax regimes to attract business of large MNEs earning "mobile income"
- Mechanism:
  - Internationally coordinated rules to ensure that large MNE's pay tax at a minimum effective rate of 15% on their "**excess profits**" in each jurisdiction they operate in;
  - Jurisdictions that refuse to adopt these rules will cede minimum tax to other jurisdictions that do.
- OECD released Model ("**GloBE**") Rules for participating jurisdictions to follow in implementing Pillar Two rules into domestic legislation.

02
INTRODUCTION TO THE GMTA

INTRODUCTION TO THE GMTA

- Canada introduced Pillar Two legislation as draft GMTA released on August 4, 2023 (separate from the ITA). The GMTA is now before Parliament in Bill C-69 (tabled on May 2, 2024).

- Proposed to be effective for years beginning on or after December 31, 2023, and applicable to "qualifying MNE groups".

- Includes two types of "top-up taxes"

  1. ***Global Minimum Top-up Tax under Part 2 ("GMTT") – Canada's Income Inclusion Rule (IIR) Top-up tax***

     Like a CFC tax (such as FAPI or GILTI) levied by Canada in respect of earnings of foreign subsidiaries and PEs of a Canadian parented qualifying MNE group.

  2. ***Domestic Minimum Top-up Tax under Part 3 ("DMTT")***

     Domestic minimum tax levied by Canada on Canadian entities and PE's in a qualifying MNE group.

- Placeholder for UTPR Rule (Part III of previous draft of the GMTA).

INTRODUCTION TO THE GMTA

GMTT (Part 2 of GMTA)

- Tax generally levied on Canadian parent of qualifying MNE group in respect of **"*excess profit*"** earned by foreign subsidiaries and PEs in each country.
- Tax can be levied on Canadian intermediate parent entity / partially owned parent entity in certain circumstances.
- Excess profit
  - *[adjusted financial accounting income, or GloBE income] minus [substance-based income exclusion ("**SBIE**")]*
  - SBIE is 10% (declining to 5% over 10 years) of the net book value of tangible assets and 8% (declining to 5% over 10 years) of the payroll costs of group entities in particular country.
- **Objective to increase the effective tax rate on foreign excess profits to 15%.**

INTRODUCTION TO THE GMTA

DMTT (Part 3 of GMTA)

- OECD Pillar Two Model rules permit jurisdictions to charge their own domestic top-up tax on profits earned therein to avoid ceding tax revenue to other countries that charge an IIR or UTPR.

- Implementing a Pillar Two compliant DMTT (a QDMTT) exempts jurisdiction from having another country's IIR (or UTPR) apply to earnings in that jurisdiction (provided election is made to apply permanent safe harbour).

- In absence of this election, QDMTT is a covered tax (i.e., creditable) for purpose of determining IIR (or UTPR) top up tax for that jurisdiction.

INTRODUCTION TO THE GMTA

DMTT (Part 3 of GMTA) (Continued)

- Once within the scope of the GMTA, calculating DMTT is mandatory for each "Constituent Entity" located in Canada (subject to transitional safe harbour).
- The DMTT calculation effectively piggy-backs the GMTT calculation (with some modifications) required to be calculated for foreign jurisdictions.
- Implementation of IIR (and UTPR) top up tax (by Canada and other high tax jurisdictions is largely a "stick" to compel other countries to implement a QDMTT. As most countries adopt QDMTTs, IIR will become less relevant (and less likely to raise revenue).

03
SCOPE OF GMTA

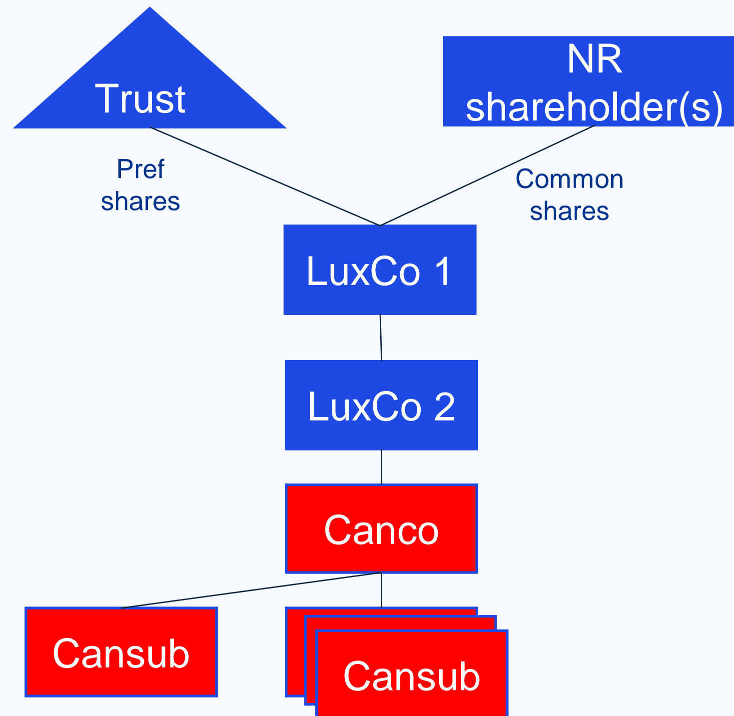
SCOPE OF GMTA

- GMTA applies to Canadian constituent entities in a "**qualifying MNE group**" – defined in GMTA s. 9(1)
- A qualifying MNE Group is an "MNE Group" that has consolidated revenues of €750M or more in two of the four fiscal years immediately preceding the particular year.
- In order to make determination of whether there is a qualifying MNE Group, need to identify:
    - "**Ultimate parent entity"** ("**UPE**") - GMTA s. 12(1)); refers to "**controlling interests**" (GMTA s. 2(1))
    - "**Group**" in respect of the UPE - GMTA s.10(2);
    - A "**MNE group**" – GMTA s.10(1) - one or more entities (including, but not limited to, partnerships and corporations) or PEs located in more than one jurisdiction.
- Where a single entity is not otherwise a member of a group, but has PEs outside of its own tax jurisdiction, it is the UPE of a group that includes its PEs.
- The GMTA does not apply to "excluded entities" within a qualifying MNE group, which generally includes government entities, international organizations, non-profit organizations, pension funds, as well as investment funds and real estate investment vehicles that are UPEs.

SCOPE OF GMTA

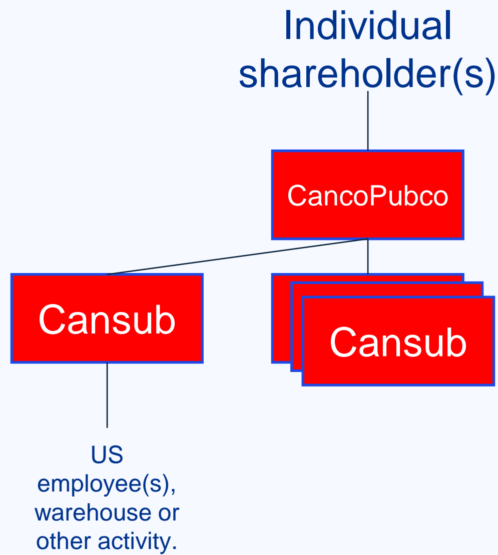
- Identifying an MNE Group and its UPE may not always be straight forward:
  - May require consultation with financial accounting experts.
    - If at a particular level, an entity prepared consolidated FS, what underlying entities would be included in the consolidation on a line-by-line basis.

Example 1

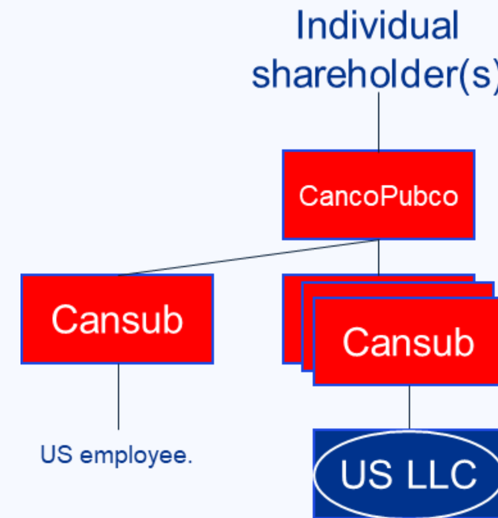


SCOPE OF GMTA

Example 2



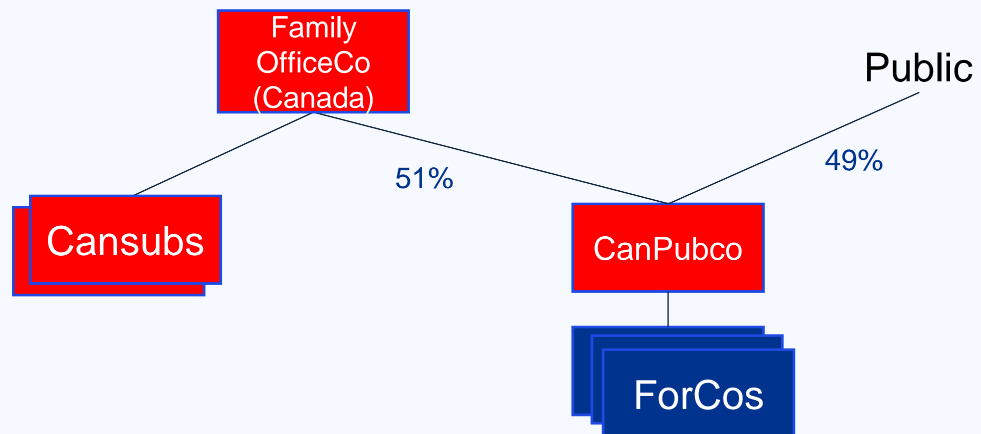
Example 3



- Is there a PE?
- Mitigating considerations:
  - GMTA 33 – De Minimis Jurisdiction exclusion
  - GMTA 53 – Avoid DMTT calcs for Canadian entities

SCOPE OF GMTA

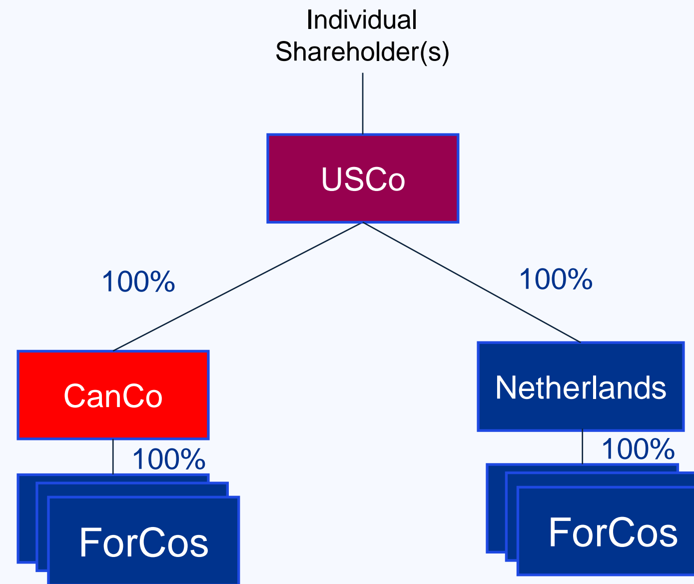
Example 4 – UPE and POPE



- Who is the UPE?
- Who is responsible for IIR top up tax? GlobE reporting and elections?

SCOPE OF GMTA

Example 5 – Canada as Intermediate parent entity / selection of designated filing entity



04
SAFE HARBOURS

SAFE HARBOURS

1. **Transitional CbCR safe harbour** - available for first 3 years (GMTA s. 47)
   - Deemed top-up tax for a jurisdiction to be nil (and eliminates need to prepare detailed computations) if one of three tests is met based on information from CbCR
     - Simplified effective tax rate test
     - De minimis threshold test
     - Routine Profits test
   - Qualification requires MNE group to have qualified country-by-country report (steps may need to be taken right away to ensure these are available).

2. **QDMTT safe harbour** – Permanent (GMTA s. 44)

3. **De minimis jurisdiction exclusion** (GMTA s. 33)

SAFE HARBOURS

Simplified effective tax rate test

- Determine implied effective tax rate for a jurisdiction based on:
  - Profits before income tax as reported in CbC report; and
  - Income tax expense based on qualified financial statements (GAAP compliant)

- Safe harbour applies if simplified ETR > 15% in first year (increasing to 17% by third year).

- Instances in which this simplified ETR test **may not be satisfied** by high tax rate jurisdictions:
  - Low effective tax rate due to recognition of accrual of investment tax credits.
  - Deferred income tax expense not recognized in FS, due to:
    - Constituent entity elects not to use deferred tax accounting (as permitted under relevant accounting standard), and thus temp differences result in understated effective tax rate; or
    - Reversal of valuation allowance
  - Profits before tax overstated relative to account tax expense due to double counting of income required in CbCR.

SAFE HARBOURS

Where is GMTA taking us?

- First three years:
  - Where conditions satisfied, qualifying MNE groups may rely on transitional safe harbours to avoid detailed top-up tax calculation for particular jurisdiction;
  - Otherwise, detailed minimum tax calculations will generally be required (under IIR and/or DMTT).

- After first three years:
  - Detailed minimum tax calculations generally required for all countries in a Canadian qualified MNE group (including Canada), subject to the De Minimis Exclusion.
    - Expected that most calculations will be for QDMTT implemented by most jurisdictions;
    - Canadian IIR will apply in rare instances to jurisdictions that do not adopt a QDMTT (which may include the US).
    - This will create big administrative burden for large MNEs, even if they are only in high tax rate jurisdictions.

05
DMTT CALCULATIONS
SELECT CONSIDERATIONS

DMTT CALCULATIONS

How is DMTT Calculated?

1. Calculate the **“Canadian ETR”**

   Canadian ETR = Sum of the Adjusted Covered Taxes of each Canadian CE ÷ Net GloBE Income of Canada

2. Calculate the “**Top-up Tax Percentage**”

   Top-up Tax Percentage = 15% - Canadian ETR

3. Calculate the “**Substance-based Income Exclusion**”

DMTT CALCULATIONS

How is DMTT Calculated?

4. Calculate DMTT for Canada

   DMTT = Top-up Tax Percentage x (Net GloBE Income of all Canadian CEs - Substance-based Income Exclusion for Canada)

5. Allocate DMTT to each Canadian CE

   DMTT of a Canadian CE = DMTT x (GloBE Income of the Canadian CE ÷ Aggregate GloBE Income of all Canadian CEs)

DMTT CALCULATIONS

Some (Significant) Fundamentals

- Most, if not all, of the components of the calculation must be determined on a stand-alone entity basis! This includes book gains and losses on intergroup transactions which must be determined based on the applicable accounting standard (even though ignored or eliminated for financial reporting purposes and no specific accounting standard for intergroup transactions)

- For Canadian groups with a foreign UPE (e.g., in-bound groups), the DMTT liability is generally calculated using the reporting currency of the foreign UPE

- Focus on rate-reconciling items (*e.g.*, permanent differences) which impact ETR. However, some are excluded for Pillar 2 purposes, for example:
  - Changes in unrecognized deferred tax assets (i.e., valuation allowances) recorded to deferred tax expense
  - Policy disallowed expenses (non-deductible illegal payments, fines and penalties ≥ €50,000)

- Generally, any component of the Canadian ETR calculation that relates to an **"Excluded Equity Gain or Loss"** is excluded

DMTT CALCULATIONS

Excluded Equity Gain or Loss

- An **excluded equity gain or loss**, of a particular constituent entity, for a fiscal year, means the gain, profit or loss included in the financial accounting income of the particular constituent entity arising from

  (summarized)

  a) FMV gains/losses or an impairment charge recorded on a non-portfolio (≥10%) ownership interest

  b) Equity accounted profits/losses recorded on an ownership interest

  c) Gains/losses from a disposition of a non-portfolio (≥10%) ownership interest

- An ownership interest can be in any entity, it does not need to be a constituent entity

EFFECTIVE TAX RATE RECONCILIATION

Some exclusions under full calculations (e.g., policy disallowed expenses)

20. Income Taxes

Year Ended December 31		2023		2022
Income before income taxes - consolidated	**$**	**912**	$	716
Statutory income tax rate (%)		**23.0**		23.0
Expected taxes at statutory rates	**$**	**210**	$	165
Add (deduct) the tax effect of:				
Permanent differences	**$**	**—**	$	2
Statutory and other rate differences		**(1)**		1
Deferred income tax recovery on regulated assets		**(16)**		(21)
Tax differences on divestitures and transactions		**37**		(3)
Other		**(7)**		(1)
	$	**223**	$	143
Income tax provision				
Current	**$**	**43**	$	23
Deferred		**180**		120
	$	**223**	$	143
Effective income tax rate (%)		**24.5**		20.0

Excluded under full calculations.

EXAMPLE 1

<u>Taxable income is less than book income due to:</u>

- Depreciation

GLoBE income	$	100
Adjusted covered taxes		
Current tax expense	$	-
Deferred tax expense @ 15% (temp diff $100*15%)	$	15
	$	15
Minimum rate		15%
Canadian ETR		15%
Top-up Tax Percentage		0%
SBIE	$	40
Excess Profit [GloBE income – SBIE]	$	60
DMTT [Top-up Tax Percentage x Excess Profit]	$	-

Book Profit/Loss		**GloBE Income**		**Tax**		**Difference**	**T / P**
Other income	$	500	$	500	$	-	
Depreciation	$	(100)	$	(200)	$	(100)	T
Other expenses (deductible)	$	(300)	$	(300)	$	-	
	$	100	$	-	$	(100)	

Rate Reconciliation		
Income before taxes	$	100
Statutory rate (%)		23.00
Expected taxes at statutory rate	$	23.00
Add (deduct) perm diffs	$	-
Income tax expense	$	23.00
ETR		23.00%

EXAMPLE 2

Tax income is less than book income due to non-share asset disposition:

- Gross capital gain for tax < book (e.g., tax = $150, book = $200)
- Capital gains inclusion rate

GLoBE income	$	100
Adjusted covered taxes		
Current tax expense	$	-
Deferred tax expense @ 15%	$	-
	$	-
Minimum rate		15%
Canadian ETR		0%
Top-up Tax Percentage		15%
SBIE	$	40
Excess Profit [GloBE income – SBIE]	$	60
DMTT [Top-up Tax Percentage x Excess Profit]	$	9

Book Profit/Loss		**GloBE Income**		**Tax**		**Difference**	**T / P**
Other income	$	300	$	300	$	-	
Gain on sale of capital property	$	200	$	100	$	(100)	P
Depreciation	$	(100)	$	(100)	$	-	
Other expenses (deductible)	$	(300)	$	(300)	$	-	
	$	100		-	$	(100)	

Rate Reconciliation		
Income before taxes	$	100
Statutory rate (%)		23.00
Expected taxes at statutory rate	$	23.00
Add (deduct) perm diffs	$	(23.00)
Income tax expense	$	-
ETR		0.00%

EXAMPLE 3

Financial statement ETR ≥ 15%

- Remeasurement of deferred tax expense @15%
- Canadian ETR < 15% = Top-up tax

GLoBE income	$	300
Adjusted covered taxes		
Current tax expense	$	23
Deferred tax expense @ 15%	$	15
	$	38
Minimum rate		15%
Canadian ETR		13%
Top-up Tax Percentage		2%
SBIE	$	40
Excess Profit [GloBE income – SBIE]	$	260
DMTT [Top-up Tax Percentage x Excess Profit]	$	6

Book Profit/Loss		**GloBE Income**		**Tax**		**Difference**	**T / P**
Other income	$	200	$	200	$	-	
Gain on sale of capital property	$	200	$	100	$	(100)	P
Depreciation	$	-	$	(100)	$	(100)	T
Other expenses (deductible)	$	(100)	$	(100)	$	-	
	$	300		100	$	(200)	

Rate Reconciliation		
Income before taxes	$	300
Statutory rate (%)		23.00
Expected taxes at statutory rate	$	69.00
Add (deduct) perm diffs	$	(23.00)
Income tax expense	$	46.00
ETR		15.33%

EXAMPLE 4

Taxes reduced by non-refundable income tax credits

GLoBE income	$	100
Adjusted covered taxes		
Current tax expense	$	3
Deferred tax expense [Excluded s. 25(2)(a)(iii)]	$	-
	$	3
Minimum rate		15%
Canadian ETR		3%
Top-up Tax Percentage		12%
SBIE	$	40
Excess Profit [GloBE income – SBIE]	$	60
DMTT [Top-up Tax Percentage x Excess Profit]	$	7

Pre-tax book income	**$**	**100**
Temporary difference	$	-
Permanent difference	$	-
Income for tax purposes	**$**	**100**
Statutory income tax rate (%)		23.00
Income tax liability before ITCs	$	23
Non-refundable ITCs claimed	$	20
Income tax liability after ITCs	$	3
Current tax expense	$	3
Deferred tax expense	$	20
Income tax expense	$	23
Effective tax rate (%)		23.00

EXAMPLE 5

Excluded Equity Gain or Loss

- Company A owns 100% of Company B.
- Statutory income tax rate is 23%
- Assume capital gain inclusion rate is 66.67%
- Year 1: Company A sells the shares of Company B and realizes a capital loss of $1,000.
- The following is recorded in Company A's financial statements:
  - DR: Book loss (P&L) $1,000
  - CR: Deferred tax recovery (P&L) $153 (1,000*66.67*23%)
  - DR: Deferred tax asset (B/S) $153

GLoBE income (loss)	$ (1,000)
Exclusion for excluded equity gain or loss [s. 18(4)]	$ 1,000
GlobE income (loss)	$ -
Current tax expense	$ -
Deferred tax expense @ 15%	$ (100)
Exclusion for excluded equity gain or loss [s. 25(2)(a)(i)]	$ 100
Adjusted covered taxes	$ -
Minimum rate	15%
Canadian ETR	15%
Top-up Tax Percentage	0%

EXAMPLE 5 (CONTINUED)

Excluded Equity Gain or Loss

- Year 2: Company A sells depreciable property and land, realizing total capital gains of $1,000 (taxable portion $667)
- Company A applies net capital loss from year 1 to reduce income tax liability in year 2 to $nil.
- The following is recorded in Company A's financial statements:
  - CR: Book gain (P&L) $1,000
  - DR: Deferred tax expense (P&L) $153 (1,000*66.67*23%)
  - CR: Deferred tax asset (B/S) $153

GLoBE income (loss)	$	1,000
Exclusion for excluded equity gain or loss [s. 18(4)]	$	-
GlobE income (loss)	$	1,000
Current tax expense	$	-
Deferred tax expense @ 15%	$	100
Exclusion for excluded equity gain or loss [s. 25(2)(a)(i)]	$	(100)
Adjusted covered taxes	$	-
Minimum rate		15%
Canadian ETR		0%
Top-up Tax Percentage		15%

ASSET TRANSFERS

GloBE Reorganization	Not a GloBE Reorganization
Accounting gains or losses of the disposing CE are excluded from Globe Income or Loss to the extent that the tax gain or loss is excluded or deferred from taxation. The portion of a gain or loss that is partially taxed is referred to as a "non-qualifying gain or loss". Accounting gains or losses are recognized to the extent of the non-qualifying gain or loss.	Accounting gains or losses of the disposing CE are included (or stay) in GloBE Income or Loss, irrespective of whether tax gains or losses were realized or not realized.
The acquiring CE inherits the accounting carrying values of the assets and liabilities of the disposing CE.	The acquiring CE recognizes the carrying value of the assets and liabilities based on accounting standards used in the consolidated financial statements of the ultimate parent entity (*i.e.*, carrying values follow the accounting).

ASSET TRANSFERS

- The GloBE reorganization classification is meant to align the accounting recognition of a gain or loss with the tax deferred treatment of reorganizations and asset transfers under domestic tax provisions

- There are pitfalls if accounting and tax do not align (e.g., book gain but no tax = decreased ETR)

- Rollovers with too much "boot" could be problematic (*e.g.*, transfers under subsections 85(1) and 97(2))

OTHER CONSIDERATIONS

- There are numerous (and not covered herein)!
- Non-exhaustive list:
  - Adjustments to accounting income to derive GloBE income
  - Exceptions from rules (e.g. shipping)
  - Various elections to manage Pillar 2 exposure
  - Identification and treatment of permanent establishments
  - Identification and treatment of stateless entities
  - Treatment of joint ventures
  - Allocation of income between relevant parent entities
  - UTPR

06 TAKEAWAYS

1. DMTT calculations will become increasingly important (not only in Canada, but worldwide) as countries adopt, and as transitional safe harbours are no longer available

2. All Canadian entities of a qualifying MNE group must calculate DMTT

3. DMTT liability in Canada is possible even though Canada is a high tax jurisdiction. The same applies for GMTT in respect of foreign high tax jurisdictions (*e.g.*, the US)

4. Need to understand tax accounting and where the pitfalls lie to reduce exposure to minimum tax (which is not refundable in the future)

QUESTIONS?