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Tax Alert – Canada

Global Minimum Tax Act released for public comment

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 4 August 2023, the Department of Finance released for public comment several packages of draft legislative proposals, including new draft legislative proposals relating to the implementation of a global minimum tax under Pillar Two of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on Base Erosion and Profit Shifting (the Inclusive Framework). More specifically, the draft *Global Minimum Tax Act* (GMTA) is intended to implement the income inclusion rule (IIR), the domestic minimum top-up tax (DMTT) rules and the UTPR (sometimes referred to as the Undertaxed Profits Rule) that form part of the Model Rules for the Global Minimum Tax (GloBE Rules) that were released by the OECD on 20 December 2021.[1]

This Tax Alert is not intended to provide a detailed overview of the GloBE Rules;[2] it is intended to provide an overview of the framework of the GMTA that was introduced as well as a discussion of certain key concepts and requirements included in the draft legislative proposals.

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[1] See the GloBE Rules.

[2] For more information on the GloBE Rules, see the following global tax alerts: (i) OECD releases Model Rules on the Pillar Two Global Minimum Tax: Detailed review , (ii) OECD releases Commentary and illustrative examples on Pillar Two Model Rules, (iii) OECD/G20 Inclusive Framework releases document on safe harbors and penalty relief under Pillar Two GloBE rules, (iv) OECD/G20 Inclusive Framework releases Administrative Guidance under Pillar Two GloBE Rules: Detailed Review, and (v) OECD/G20 Inclusive Framework releases additional Administrative Guidance on Pillar Two GloBE Rules: Detailed review.

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Background

Canada is one of 143 members of the Inclusive Framework that have endorsed a two-pillar plan for international tax reform agreed to on 8 October 2021. Pillar One involves the introduction of rules to create new taxing rights in favour of jurisdictions into which goods and services are sold, while Pillar Two involves the introduction of a global minimum tax requirement set at a 15% effective tax rate.

The GloBE Rules apply to Constituent Entities that are members of a Multinational Enterprise (MNE) Group that has annual revenue of €750 million or more in the Consolidated Financial Statements of the Ultimate Parent Entity (UPE) in at least two of the four fiscal years immediately preceding the tested "fiscal year".

On 4 August 2023, the Department of Finance released a consultation draft of the GMTA to implement the GloBE Rules, with effect in general for fiscal years of MNEs that begin on or after 31 December 2023 as well as a revised draft of Canada's domestic digital services tax (DST), which is intended to serve as a backstop to the Pillar One proposals.

The GMTA so far only includes detailed rules on the IIR and the DMTT. The final part of the GloBE Rules, which is the backstop rule referred to as the UTPR, is expected to be released at a later date, with effect for fiscal years of MNEs that begin on or after 31 December 2024. Further, since the GMTA is structured as a separate statute and not as part of the federal *Income Tax Act* (ITA), additional amendments to the ITA are expected to be released to better align the GMTA with the ITA.

Interested parties are invited to provide comments on the DST until 8 September 2023 and on the GMTA until 29 September 2023.

Framework

To facilitate review with the published guidance by the OECD, the Department of Finance released a table of concordance[3] alongside the release of the GMTA to reconcile the GMTA with the GloBE Rules, and the related GloBE commentary[4] (the Model Commentary), the administrative guidance in respect of the GloBE Rules[5] (the Administrative Guidance), the GloBE Information Return[6] and the GloBE Safe Harbours and Penalty Relief document.[7] The GMTA generally follows the GloBE Rules, with some expected deviations. The framework of the GMTA is as follows:

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3 See Table of concordance.
4 See the Model Commentary.
5 See the February 2023 Administrative Guidance and the July 2023 Administrative Guidance.
6 See GloBE Information Return.
7 See GloBE Safe Harbours and Penalty Relief.

Part I – Interpretation and Rules of Application (section 1 to 13)

- Definitions contained in subsection 4(1)

Part II – Global Minimum Tax (section 14 to 47)

- Division A – Liability for Tax (section 14 to 15)
- Division B – Computation of GloBE income or loss (section 16 to 21)
- Division C – Computation of Adjusted Covered Taxes (section 22 to 28)
- Division D – Computation of Effective Tax Rate and Top-Up Amount (section 29 to 37)
- Division E – Reorganizations and Asset Transfers (section 38 to 39)
- Division F – Multi-parented MNE Groups (section 40)
- Division G – Elections in relation to Investment Entities (section 41 to 42)
- Division H – Safe Harbours and Simplifications (section 43 to 45)
- Division I – Transition Rules (section 46 to 47)

Part III – UTPR

Part IV – Domestic Minimum Top-Up Tax (sections 48 to 51)

Part V – Anti-Avoidance (section 52)

Part VI – General Provisions, Administration and Enforcement (sections 53 to 135)

Part VII – Regulations (section 136)

Regulations are mentioned throughout the GMTA, so we expect there to be formal regulations released at a later time that will accompany the GMTA. It is important to note that the GloBE Rules focus largely on financial accounting income/loss; consequently, it will be crucial to ensure all relevant adjustments are booked in the financial accounting income/loss on a timely basis to determine the appropriate result under the GloBE Rules.

Partnerships

A partnership formed under Canadian law is included in the definition of an "entity" and can therefore be a "constituent entity" under subsection 11(1) of the GMTA, provided it is part of a "group" and is not an "excluded entity". An excluded entity is defined in subsection 13(1) of the GMTA and includes a governmental entity, international organization, non-profit organization and pension fund, as well as an investment fund or real estate investment vehicle that is a UPE. In addition, investment funds that are not UPEs can qualify as investment entities and thereby be excluded from other aspects of the rules (for example, an investment entity cannot be a partially owned parent entity). The exclusion for investment funds is important, but some investment fund partnerships may not be excluded. Also, the exclusion of the fund itself does not necessarily exclude constituent entities owned by the fund.

A partnership that is located in Canada and that is not an excluded entity may therefore be required to report and pay top-up tax in Canada if it is a relevant parent entity. As a flow-through entity, a Canadian partnership should be considered to be located in Canada if it is the UPE, or if it is a particular intermediate parent entity or a partially owned parent entity that has an ownership interest in at least one constituent entity of the "MNE group" that has a top-up tax amount and that is not located in Canada. Canadian partnerships that meet these conditions will need to carefully consider their tax payment and reporting obligations under the GMTA.

A Canadian partnership that is not a UPE or other relevant parent entity will generally be considered stateless. However, its GloBE income (if any) may be not stateless and is generally allocated to its owners in accordance with the rules in section 17 of the GMTA, unless the partnership is not a tax transparent entity (in which case, its income or loss would normally remain allocated to the partnership itself and be considered stateless).

Arm's length

The arm's length requirements in subsections 18(13) and 18(14) of the GMTA follow current Administrative Guidance with some clarification in respect of bilateral transfer pricing adjustments. In particular, subsection 18(13) requires application of the arm's length principle to transactions between constituent entities located in the same jurisdiction in certain circumstances only, while subsection 18(14) generally requires GloBE income or loss to be adjusted to reflect both bilateral and unilateral transfer pricing adjustments, where such adjustments are necessary to prevent double taxation or double non-taxation. However, as noted in the Model Commentary, the Inclusive Framework is still considering other appropriate adjustments in this context, including where the tax authorities in two or more jurisdictions disagree on the application of the arm's length principle, and therefore no such adjustments are yet reflected in the GMTA.

Where transfer pricing adjustments arise in respect of a prior year resulting in what would have been a decrease in the anticipated top-up tax, there is currently no mechanism to obtain a refund of such taxes outside of the normal refund process described below in *Administrative Matters*. Consequently, care should be taken to ensure appropriate objection or refund processes are followed under the GMTA, where available.

Temporary differences and transitional tax attributes

Mechanism to address temporary differences

Section 25 of the GMTA provides the mechanism to address temporary differences for purposes of calculating "covered taxes". These rules are generally aligned with mechanisms set forth in Article 4.4 of the GloBE Rules.

Notably, the GMTA introduces the "substitute loss carry-forward recapture amount" concept via specific legislation (subsections 25(3) and 25(4)) to codify the Administrative Guidance in respect of the GloBE Rules to address identified unintended downward distortions of a constituent entity's effective tax rate that could arise where the following conditions are present:

i) in determining the income subject to tax, a jurisdiction requires that domestic source losses offset foreign source income before applying foreign tax credits;

ii) the constituent entity has a domestic tax loss that fully or partially offsets foreign source income; and

iii) the domestic tax regime allows foreign tax credits to be used to offset a tax liability in a subsequent year in relation to income that is included in the computation of the constituent entity's GloBE income or loss.

GloBE Loss Election

Section 26 of the GMTA aligns with Article 4.5 of the GloBE Rules and allows for a constituent entity to address temporary differences by electing to apply the GloBE Loss Deferred Tax Asset mechanism in lieu of the principal mechanisms found in Section 25 of the GMTA (Article 4.4 of the GloBE Rules).

Transitional tax attributes

Section 46 of the GMTA contains the Tax Attributes on Transition rules and is generally aligned with the GloBE Rules (in Articles 9.1 to 9.3). Subsections 46(5) and 46(8) provide the mechanism to address opening deferred tax assets and liabilities of a constituent entity that exist in the year that the minimum tax rules come into effect. In general terms:

i) deferred tax assets and deferred tax liabilities of a constituent entity reflected or disclosed in the financial accounts should be taken into account at the lower of their actual balance and the balance that would have been obtained had such deferred tax assets or liabilities been measured at the minimum tax rate;

ii) a deferred tax asset that has been recorded at a rate lower than the minimum tax rate may be recorded at the minimum tax rate if the taxpayer can demonstrate that the deferred tax asset is attributable to a "GloBE loss";

iii) deferred tax assets arising from items excluded from the computation of "GloBE income or loss" must be excluded from the transitional tax attribute computation when such deferred tax assets are generated in a transaction that takes place after 30 November 2021; and

iv) special rules apply to deferred tax assets and liabilities arising on asset transfers between constituent entities after 30 November 2021 and before the commencement of the year in which the minimum tax rules come into effect.

Subsections 46(5) to 46(9) of the GMTA also specifically codify some of the Administrative Guidance, which provides greater clarity on the application of the special rules applicable to intercompany asset transfers.

Credits

The GMTA generally adopts the definition of "qualified refundable tax credit" and "non-qualified refundable tax credit" and the explicit, mandatory treatment applicable thereto, as laid out in the GloBE Rules. It is important to note, however, that the GMTA does not contain any specific rules addressing Marketable Transferable Tax Credits, Non-Marketable Transferable Tax Credits and Other Tax Credits, as each of these terms is defined by the July Administrative Guidance. We expect further guidance or legislative updates to address transferability in the context of the GMTA as it is anticipated that governments will want to align their incentive policies to optimize their treatment for purposes of the global minimum tax framework.

General anti-avoidance rule

Canada's general anti-avoidance rule (GAAR) contained in section 245 of the ITA also applies in respect of any amount under the GMTA. Consequently, the proposed legislative amendments to modernize and strengthen the GAAR, which were also released for consultation on 4 August 2023 (with some legislative modifications since their release on 28 March 2023), will also apply. It is unclear at this time how the GAAR will be applied in relation to the GMTA.

Domestic Minimum Top-Up Tax

Part IV of the GMTA provides the rules in connection with the DMTT with express intention in section 48 for it to be a qualified domestic top-up tax (QDMTT) that has QDMTT safe harbour status. Consistent with what has been released in the Administrative Guidance, the objective of the DMTT is to:

a) determine the "excess profit" (i.e., GloBE income less the "substance-based income exclusion amount") in a manner that is equivalent to the GloBE Rules;

b) operate to increase Canadian tax liability with respect to Canadian "excess profit" to the "minimum rate" for the fiscal year; and

c) be implemented and administered in a way that is consistent with the outcomes provided for under the GloBE Rules and the Model Commentary.

Conditions

Subsection 49(1) indicates that a particular person must pay a tax in respect of a constituent entity of an MNE group for a fiscal year in an amount equal to the domestic top-up tax amount of the constituent entity for the fiscal year if:

a) the constituent entity is located in Canada for the fiscal year;

b) the MNE group is a qualifying MNE group for the fiscal year; and

c) the particular "person" (which includes an individual, a corporation, a partnership or a trust) (i) is the constituent entity; or (ii) if the constituent entity is not a person, would, under the relevant assumptions, include in its income for the purposes of Part I of the ITA income of the constituent entity for the fiscal year.

Determination of Canadian jurisdictional GloBE income

The domestic top-up tax amount of a constituent entity of an MNE group located in Canada means the amount that would be the top-up tax amount of the constituent entity determined under subsection 30(1) (Top-up tax of a standard constituent entity), 34(2) (Minority-owned constituent entity - top-up amount), 35(1) (Joint venture - top-up amount), or 36(2) (Investment subgroup entity - top-up amount), as the case may be and as adjusted under any other applicable provision of Part II (e.g., such as due to elections made or revoked).

Determination of Canadian covered taxes

Covered taxes in the domestic top-up tax amount calculation are determined without reference to (i) the allocation of taxes from a main entity (outside of Canada) to a permanent establishment (PE); (ii) the allocation of controlled foreign company (CFC) taxes borne outside of Canada; (iii) the allocation of taxes paid by a constituent entity owner (hybrid entities); and (iv) taxes on distributions except any amount of those taxes imposed under the ITA (e.g., dividend withholding tax under Part XIII of the ITA).

For example, in respect of a Canadian PE of a nonresident, to the extent that the nonresident (i) pays Canadian income tax on the GloBE income under the ITA, and (ii) pays additional income tax in the jurisdiction in which the nonresident is resident in respect of the same GloBE income, the general rules to determine Canadian jurisdictional Covered Taxes (i.e., for the purposes of applying an IIR or UTPR) would allocate to Canada both the domestic and foreign taxes paid on the Canadian GloBE income. However, the DMTT rules are such that only the Canadian taxes would be allocated for those purposes.

Administrative matters

Part VI of the GMTA provides a framework for administration and enforcement. Part VI addresses Returns, Payments of tax, Interest, Refunds, Record retention, Assessments, Objections to Assessments, Appeals, Penalties, Offences and Punishment, Inspections, and Collection, among other topics. In large measure the provisions in this Part are modelled after similar provisions in the ITA, although with certain notable differences.

Returns

A GloBE Information Return (GIR) must be filed in Canada, or the CRA must be notified of a foreign filing of the GIR, before the GIR due date, which is generally 15 months after the last day of the UPE's fiscal year (except in the first year of filing, when it is 18 months). The contents of the GIR are aligned with the OECD framework and are outlined in subsection 59(4) of the GMTA.

Further, persons liable for tax under Part II (IIR) or Part IV (DMTT) must also file returns under those Parts by the GIR due date for the year. If more than one person is required to file a Part IV return, one person that is a resident of Canada — the Canadian filing entity — can be designated to file the required return on behalf of the MNE group.

Payments

Tax payable under the GMTA must be paid on or before the GIR due date for the fiscal year and be paid in Canadian dollars pursuant to subsection 67(1). If the amount payable is determined in a currency other than Canadian dollars, the amount should be converted to Canadian dollars pursuant to subsection 67(2).

Refunds

A person who has paid an amount in error to the CRA can apply for a refund of the amount within two years after the day on which the moneys were paid. The CRA must consider the application without delay and determine the amount of the refund payable to the applicant. A determination by the CRA is subject to objection and appeal.

Assessments

Reassessment of tax is limited to a period of seven years after the *later of* the day of filing the return to which the tax relates or the day on which the CRA receives the GIR. However, records and information generally must be maintained for a period of eight years after the end of the fiscal year to which they relate. Exceptions to the limitation period are allowed to give effect to a decision on an objection or appeal, in the case of misrepresentation or fraud, where an amount paid relates to another fiscal year, or where the person has filed a waiver of the time limit.

Objections and Appeals

An objection to an assessment may be made within 90 days after the date of a notice of assessment. An extension of the time may be allowed for up to one year after the expiry of the 90 days subject to the discretion of the Minister of National Revenue (the Minister).

A person may appeal to the Tax Court of Canada if (i) the Minister confirms the assessment or has reassessed; or (ii) 180 days have elapsed after the filing of the notice of objection and the Minister has not notified the person that the Minister has vacated or confirmed the assessment or has reassessed.

Penalties

If one or more constituent entities of a qualifying MNE group located in Canada are required to file a GIR in respect of the MNE group and fail to file the GIR, or fail to file a substantially complete GIR, or fail to notify the CRA of a foreign filing of the GIR, by the GIR due date, each constituent entity in Canada is jointly and severally, or solidarily, liable to a penalty of $25,000 per month, for each complete month that the GIR or notification is late, up to 40 months (i.e., $1,000,000).

A late-filed Part II (IIR) or Part IV (DMTT) return will incur a penalty of 5% of the tax payable plus 1% per month up to 12 months.

An unusual feature is a penalty for filing an unreasonable appeal. If the Tax Court of Canada disposes of an appeal or an appeal has been discontinued or dismissed without trial, the Court may, upon application by the Minister, order the person to pay an amount not exceeding 10% of any part of the amount in controversy in respect of which the Court determines there were no reasonable grounds for the appeal, if in the opinion of the Court one of the main purposes for instituting or maintaining any part of the appeal was to defer the payment of any amount payable. There is no parallel for any assessments determined to be unreasonable.

Collection

The GMTA's collection provisions largely mirror those in the ITA, except that whereas the latter allows collection of 50% of amounts in dispute by defined "large corporations", the GMTA defers collection of amounts in dispute until after resolution, except that if the total unpaid tax exceeds $1,000,000, the CRA may collect up to 50% of the total. The CRA may also accept security for any amount payable.

What's next

While the proposed legislation in the GMTA addresses several components of the GloBE Rules, the Model Commentary and the Administrative Guidance, certain components have not yet been considered in detail, including:

- Credits
  - Clarification is still required on the treatment of transferable tax credits under the GMTA.

- DMTT/QDMTT
  - Clarification with respect to the adjustments required in a new transition year;
  - The information collection and reporting requirements under the DMTT in the context of the GIR;
  - Clarification of the meaning of QDMTT paid or payable to address cases where the QDMTT is not paid within four fiscal years or not payable under the GloBE Rules; and
  - Development of a mechanism for re-computation to minimize the potential for double taxation and double non-taxation under the GloBE Rules.
- Transfer pricing
  - Clarification from the OECD or the GMTA for instances where transfer pricing adjustments occur in a subsequent year that may have resulted in less top-up tax than would otherwise have been due in the prior year.

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