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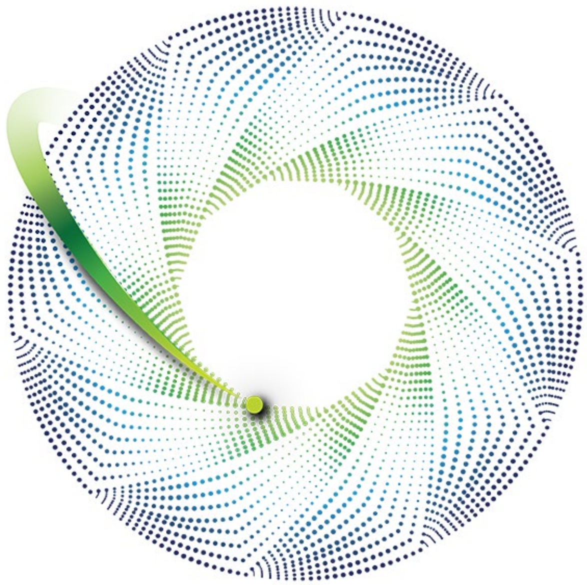

Canadian Tax & Legal Alert

Canada enacts legislation for implementation of Pillar Two rules – Global Minimum Tax Act

July 19, 2024

On June 20, 2024, Canada enacted new legislation imposing a 15% global minimum tax on profits, which will have significant implications for Canadian multinational corporations and those with activities in Canada. The new Global Minimum Tax Act (GMTA) legislates an income inclusion rule (IIR) and a qualified domestic minimum top-up tax (QDMTT). The GMTA applies retroactively and implements the IIR and QDMTT for fiscal years that begin on or after December 31, 2023 (i.e., as of January 1, 2024, for calendar-year taxpayers). The undertaxed profit rule (UTPR) is expected to come into effect on December 31, 2024 (i.e., as of January 1, 2025, for calendar-year taxpayers).

On May 2, 2024, Bill C-69 was tabled in the House of Commons, following the release of a Notice of Ways and Means Motion on April 30, 2024, for the enactment of certain provisions of the 2024 Budget, which included the GMTA, a regime based on the Pillar Two rules of the Organization for Economic Co-operation and Development (OECD). Bill C-69 received Royal Assent on June 20, 2024. The new minimum tax should apply to in-scope multinational enterprises with consolidated annual revenues exceeding EUR 750 million.

For calendar year-end taxpayers, the enactment of the GMTA in Canada may trigger financial reporting considerations related to disclosures and reporting of relevant top-up tax amounts, depending on the applicable financial reporting guidance with respect to the June 30, 2024, reporting period. This timeline may leave corporations with limited time to analyze the impact of the GMTA on their financial statements, including the potential application of the transitional safe harbours, and carrying out related discussions with auditors.

The enactment of the GMTA follows the statement on the components of global tax reform, agreed by more than 135 members of the G20/OECD Inclusive Framework (OECD Inclusive Framework) in October 2021, and the subsequent publication by the OECD Inclusive Framework of Model Rules for Pillar Two, related commentary (including Consolidated Commentary), safe harbours and administrative guidance released since (collectively the "OECD Model Rules" or "GloBE Rules"). The GMTA is intended to align with the OECD Model Rules.

The GMTA, as enacted, contains legislation on relevant definitions for interpretation (Part 1), liability for tax under the IIR (Part 2), domestic minimum top-up tax (Part 3), general anti-avoidance rule application (Part 4), administration of the GMTA (Part 5), and regulations (Part 6).

The Department of Finance has issued Explanatory Notes to the GMTA, and an updated Table of Concordance, a cross-reference to the source documents on which the GMTA is based, was also issued after Bill C-69 was tabled. The Table of Concordance and the Explanatory Notes do not include references to the OECD's guidance issued on June 17, 2024. The GMTA contains an interpretational provision whereby Part 1, 2, and relevant provision of Part 5 that implement the GloBe Rules, are to be interpreted consistently with OECD Model Rules, including administrative guidance released from time to time. That being said, given the GMTA is not a direct copy of the OECD Model Rules, it is not clear whether the GMTA, as enacted, will provide for the same outcomes as those under the OECD Model Rules and related administrative guidance.

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OECD Pillar Two rules

Pillar Two focuses on Base Erosion and Profit Shifting (BEPS) challenges and proposes a systematic solution requiring large corporations pay a minimum tax of 15% on income earned in each jurisdiction in which they operate, as calculated for the purpose of the GloBE Rules. This is referred to as the Effective Tax Rate (ETR). The minimum level of tax is applicable where the Multinational Entity Group (MNE Group) has global revenue exceeding EUR 750 million, as reported in the consolidated financial statements of the MNE Group's Ultimate Parent Entity (UPE). This threshold must be met in at least two of the four fiscal years immediately preceding the relevant fiscal year. Where the MNE Group meets this threshold, it is considered in the scope of the Pillar Two rules and subject to the minimum top-up tax.

Pillar Two can be categorized into two main components, one being the Subject to Tax Rule and the other being the GloBE Rules, namely the IIR, UTPR, and QDMTT. The GMTA in Part 2 states where the ETR is below the minimum threshold for a particular jurisdiction, the income will be subject to a top-up tax in Canada in two scenarios:

1. Where the person is a relevant parent entity of the MNE Group and is located in Canada at any time in the fiscal year and has a (direct or indirect) ownership interest in one or more Constituent Entity (CE) of the MNE group that are not located in Canada, and the CE have a top up amount for the fiscal year, or
2. Where the person would include in its income under Part I of the Income Tax Act (ITA) income for the fiscal year of a relevant parent entity located in Canada and has a (direct or indirect) interest in a CE of the MNE Group that is not located in Canada and that CE has a top-up amount for the fiscal year.

The GloBE regime also includes safe harbours to relieve MNE Groups with operations in low-risk jurisdictions from performing full GloBE calculations. If one of three tests is satisfied, the transitional Country-by-Country safe harbours that would deem top-up tax in that jurisdiction to be nil and exclude an MNE's operations in certain lower-risk jurisdictions from the scope of GloBE rules if the fiscal year begins before December 31, 2026, but not including fiscal years that end after June 30, 2028. Permanent safe harbours under specific circumstances are also available after the transition period, such as the QDMTT safe harbour, which turns off the application of the GloBE Rules in a jurisdiction whose local QDMTT meets certain standards verified by a peer review process. In practice, this may cause foreign legislation pertaining to the GloBE Rules to supersede the GMTA.

Key topics

- **Private companies that report under ASPE:** The definition of consolidated financial statements in subsection 2(1) of the GMTA has changed with the removal of the parenthetical exception in a scenario where no consolidated financial statements are prepared. With ASPE offering a policy choice concerning consolidating results of a controlled group, the initial GMTA draft lacked clarity on applying the definition with a policy choice compared to a requirement to consolidate. The removal of the parenthetical exception in the definition clarifies that in circumstances where a policy choice is made by an entity to not consolidate results under ASPE, such an entity should nonetheless be considered as the UPE of the MNE group. Reporting requirements, including the filing of the Group Information Return (GIR) and liability for top-up tax under the QDMTT or IIR, would thus be required under the GMTA.

- **Tax credits:** Tax credits, such as the marketable transferable tax credit and non-marketable transferable tax credit, have been included in the GMTA, in line with July 2023 administrative guidance released from the OECD. Further, the definition of non-qualified refundable tax credit (NQRTC) has been removed. Under the GloBE Rules, NQRTCs are treated as a reduction to tax expenses compared to qualified refundable tax credits (QRTCs), such as government grants, which are added to income. Canada's Scientific Research and Experimental Development (SR&ED) regime would not, in its current form, meet the definition of a QRTC. Therefore, an MNE with significant SR&ED tax credits, depending on treatment for financial accounting purposes, could have a lower effective tax rate than anticipated, and be subject to top-up tax by virtue of the DMTT. However, there has been a concerted effort by the Department of Finance to create and implement tax incentives that meet the QRTC conditions, such as the recently enacted Clean Energy investment tax credits, and consultation regarding changes to Canada's SR&ED program remains ongoing. Therefore, further guidance from the Department of Finance would be welcomed, given that removing the NQRTC classification would be a deliberate departure from the GloBE rules classification of tax credits.

- **Joint ventures:** Joint ventures (JV) can be common for MNE Groups to enter into with other third parties. In most cases, no single party controls a JV. Consequently, for accounting purposes, they are generally not consolidated on a line-by-line basis but instead use the equity method. Because of this, absent a particular rule, JVs would be excluded from the definition of a CE (which requires line-by-line consolidation) and out of the scope of the GloBE rules. It is important to note that the definition of JV for the GloBE rules differs from that of the usual accounting rules. Under the GMTA, a JV means an entity whose financial results are accounted for using the equity method, provided the UPE holds directly or indirectly at least 50% interest. As a result, an entity is not a JV under the GloBE rules if the UPE holds less than 50%, where it may otherwise be a JV under accounting rules. The definition of JV Parent was removed from the updated subsection 2(1) of the GMTA. The definition of a JV Group was revised to mean a JV and its JV subsidiary, if any. The update clarifies that a JV Group may exist for the GMTA where only a singular entity, without any subsidiaries, is owned by a particular MNE Group at least at 50% and accounted for under the equity method of accounting. Where a JV entity exists, the GloBE income or loss, adjusted covered taxes, and top-up tax of the JV Group are computed separately and standalone from the remaining CEs in that jurisdiction.

- **Passive income:** The definition of passive income was included in the updated subsection 2(1) of the GMTA to align with the OECD Model Rules. Passive income captures income that is a dividend or dividend equivalent, interest or an interest equivalent, rent, royalty, annuity, or a net gain from property of a type that produces income described in any of the preceding listed elements. Passive income is relevant in allocating covered taxes for controlled foreign companies to determine adjusted covered taxes under the GMTA. Paragraph 24(4)(c) of the GMTA indicates the allocation of particular controlled foreign company taxes between CEs is limited to the extent such taxes are applicable in whole or in part with respect to the passive income of the controlled foreign company. The passive income definition continues to differ from the definition of foreign accrual property income (FAPI) under subsection 95(1) of the ITA.

- **Intra-group financing arrangements:** Subsection 18(18) of the GMTA, formerly subsection 18(16), has been amended, such that paragraph 18(18)(b) now considers whether a high-tax counterparty "can reasonably be considered to be eligible for an exclusion, exemption, deduction, credit or other tax benefit under local law," compared to the replaced provision that previously considered whether an arrangement "can reasonably be considered to be excluded, reduced, offset or otherwise effectively sheltered from tax under local law by reason of any exemption, exclusion, deduction, credit or other form of relief."[1] The rules regarding intra-group financing arrangements are anti-avoidance rules and are intended to limit a low-taxed CE's expenses from the computation of GloBE income (loss) if the expense is reasonably expected not to be included in the taxable income of a high-tax counterparty. The change directly adopts the wording provided in the OECD's commentary regarding the application of Article 3.2.7, the equivalent to subsection 18(18) of the GMTA. However, the alignment, together with the issued Explanatory Notes to the GMTA, does not explicitly clarify identified concerns regarding the breadth of the anti-avoidance rules, such as circumstances where losses or other tax attributes are used, involving ordinary transactions between a low-tax CE and a high-tax counterparty.

- **Allocation of profits and taxes in groups including flow-through entities**: The GMTA definitions for owner, ownership interest, tax transparent entity, and flow-through entity, and the related provisions in the GMTA with respect to those provisions, have been amended such that they address (some) previous concerns regarding the allocation of profits and taxes to and from "flow-through entities." Flow-through entities are broadly entities which are treated as transparent in their country of creation. The modified definitions address circumstances related to a situation where a flow-through entity is itself held directly by another flow-through entity. Important to note, the GMTA definitions were modified and issued prior to the OECD's June 17, 2024, guidance which specifically included guidance on the issue, and the provisions and their impact on a particular structure need to be read together but may not yield consistent outcomes.

- **General anti-avoidance rule**: The syntax under the general anti-avoidance rule has changed to include "for the purposes of this Act, with any modifications that the circumstances require,"[2] while removing "in respect of the determination of any amount under this Act."[3] The definition of the general anti-avoidance rule has remained the same despite the change in syntax.

- **Offences and punishment:** Offences under the GMTA can now result in imprisonment for periods ranging from 12 months to five years, depending on the nature of the offence, such as failure to file or comply, making false or deceptive statements, or failure to pay tax under the GMTA. Monetary fines remain applicable in addition to the imprisonment possibility for specified offences under section 106 of the GMTA. Taxpayers should take proactive steps to prepare all filings, notification requirements and tax liabilities under the GMTA so they are satisfied by the specified due dates.

Qualified domestic minimum top-up tax

The GMTA includes a Canadian domestic minimum top-up tax (DMTT) which will impose a top-up tax in Canada on the low-taxed income of Canadian CEs. The Canadian DMTT is intended to be a QDMTT as defined in the OECD Model Rules and is expected to prevent other jurisdictions from applying top-up tax under the IIR on such Canadian-sourced income.

For Canadian entities within an MNE Group (Canadian or foreign-parented), the Canadian QDMTT permits computations to be completed by applying the acceptable financial accounting standard of the MNE Group's UPE. Therefore, in a Canadian inbound context, entities will have some level of simplification concerning having financial statement support to complete

[1] Canada, Department of Finance, Legislative Proposals Relating to the Global Minimum Tax Act (Ottawa: Department of Finance, August 2023), subsection 18(6).
[2] GMTA, section 54.
[3] Supra note 1, section 52.

the Canadian QDMTT calculation without otherwise translating, converting, or creating new financial statements under acceptable financial accounting standards recognized in Canada.

DMTT is payable by a particular person in respect of a Canadian-based CE of an MNE Group and is equal to the domestic minimum top-up amount. The particular person is the CE or, if not the CE, the person that would, subject to certain assumptions, include in its income for Part I of the ITA income of CE for the fiscal year.

The DMTT amount would be the top-up amount determined for the IIR purposes subject to specific rules, including provisions on limitations with the allocation of adjusted covered taxed for DMTT purposes and application of any elections for GloBE purposes.

The updated GMTA also clarifies that the Canadian QDMTT is intended to be implemented with QDMTT safe harbour status, including transitional qualified status, to facilitate administrative relief where the QDMTT and IIR may attempt to impose a top-up tax on the same jurisdiction in a given fiscal year.

Canadian compliance considerations

- **New filing obligations:** To the extent an MNE Group falls within the scope of the GloBE rules, there should be new filing requirement(s) in Canada. The type of filing(s) will depend on the MNE Group's footprint, the UPE's location, and the resulting tax obligations. It is important to note there may be multiple filing obligations, such as a GIR/GIR Notification, Part II tax return and/or Part IV tax return (discussed further below).
- **GloBE Information Return:** To the extent an MNE Group falls within the scope of the GloBE rules and the UPE is in Canada, a Globe Information Return should be filed with the Canada Revenue Agency (CRA), the deadline of which is 18 months after the fiscal year-end for the first year, and 15 months for years thereafter (GIR Due Date).
- **GIR Notification:** To the extent an MNE Group falls within the scope of the GloBE rules and the UPE is located outside Canada and otherwise files a GIR in a foreign jurisdiction, the MNE Group should file a GIR Notification informing the CRA of where the GIR has been filed. The deadline for this notification is the same as the GIR Due Date.
- **Part II tax return:** Those liable to pay tax in Canada under the IIR for a fiscal year should file a Part II tax return in the prescribed form, the deadline of which is the same as the GIR Due Date.
- **Part IV tax return:** Those liable to pay tax in Canada under the DMTT for a fiscal year should file a Part IV tax return in the prescribed form, the deadline of which is the same as the GIR Due Date.
- **Appointment of designated notification entity:** If more than one CE of a qualifying MNE Group is required to notify the Minister for the fiscal year, a CE located in Canada may be appointed as the designated notification entity and provide the Minister, on or before the GIR Due Date, a notification in respect of the MNE Group on behalf of the other CEs for the fiscal year. When the notification is provided to the Minister, it will be deemed as provided at that time by each of the other CEs of the MNE Group that are located in Canada.
- **Penalties for failure to file GIR/GIR Notification:** The penalties for failing to comply with the notification and GIR filing obligations are significant. The penalty is $25,000 per complete month of late filing to a maximum penalty of $1,000,000. This does not apply if the fiscal year begins before January 1, 2027, and ends before July 1, 2028.
- **Non-arm's length transfers**: The GMTA includes a provision that is similar to section 160 of the ITA. The provision allows the CRA to assess a transferee with some (or all) of the tax debt of the transferor. The restriction is extended to current and former partners of a partnership. In the case where property is transferred, the CRA may impose a penalty that is the lesser of 50% of the amount payable under the GMTA on a joint and several, or solidary, liability basis, or $100,000.
- **Penalty for failure to file a Part II or IV tax return:** The penalty is equal to the total of (a) 5% of the tax owing that was unpaid on the day on which the return was required to be filed, and (b) 1% of the unpaid amount multiplied by the number of complete months of late filing, not exceeding 12.

Key areas for organizations to consider

As expected, the GMTA legislation closely conforms with the OECD Model Rules. The GMTA will significantly alter timelines and risks associated with financial statement preparation (accounting) and tax return filing (compliance). The GMTA may be applicable to private corporations or trusts that otherwise may not have had the requirement to prepare consolidated financial statements. While the exact impact of the GMTA will vary across organizations, here are critical areas for tax, finance, and accounting teams to consider right now:

- **Local integration:** While the GMTA generally aligns with the OECD Model Rules, the legislation is not a direct translation or copy. The noted changes in this version of the GMTA are direct changes from the Department of Finance to refine the legislation to accord with feedback received from Canadians regarding the application of the GloBE Rules to Canada. Therefore, it is the responsibility of each organization to confirm that any GloBE Rules analysis or assessment is appropriately tailored to account for any GMTA variances to a particular fact pattern.
- **People:** The GMTA includes new rules, technicalities, and effective dates for organizations to digest and apply, and a collaborative team will be vital. To meet the new reporting and compliance obligations set out under the GMTA, such as preparing and reporting on complex calculations, authoring accounting disclosures, and fielding questions from auditors, team members will need to draw on existing skills and will have to learn new ones, such as technology and data gathering and data mining.
- **Data:** The GMTA will require organizations to report more than 100 new accounting, tax, and business data points, each requiring effort to identify, access, or create. Tax teams must determine where the required data will come from and which tools will be necessary to access it. Where the GMTA applies as of January 1, 2024, with the transitional safe harbours allowing for some simplification in the early years, the implementation of any data plan will need to evolve over time. While the transitional safe harbour rules provide for simplified computations, in practice, organizations may find that various factors may preclude reliance on the transitional safe harbours in jurisdictions that might have otherwise been expected to be eligible for the relief.
- **Processes:** The GMTA amplifies the overlap and the differences between accounting and compliance for income taxes. For accounting, organizations must consider incorporating GloBE calculations and controls into the financial preparation processes, systems, and deadlines. For compliance, groups must establish policies and practices and build or buy new tools to meet expected detailed calculations.

Given the enactment of the GMTA, the key action items for in-scope organizations should be:

- Addressing impact of GMTA on financial reporting requirements for periods ending on or after June 20, 2024, including urgently assessing the application of the transitional safe harbour rules;
- Reviewing accessibility to and accuracy of data sources and processes relevant to the transitional safe harbour rule assessment and computations required under the GMTA;
- Planning for integration of the GMTA into the compliance cycle, with the first Canadian GIR in respect of a qualifying MNE Group for a fiscal year is due the later of (a) June 30, 2026, and (b) 18 months following the last day of the first fiscal year in which a CE or a joint venture located in Canada is subject to the QDMTT or IIR. Following the first year, the GIR Due Date is 15 months following the last day of the fiscal year.

How can Deloitte help?

Deloitte's OECD Pillar Two Tax Advisory service brings together the expertise of Deloitte tax specialists and the analytical power of our data and technology solutions to help multinational businesses assess and evaluate the tax implications of global tax reform. We offer support for everything from initial gap assessment, through tax impact analysis, to implementation, including the following end-to-end services:

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