OECD'S Global Tax Reform 2021

Toolbox Webinar, December 1, 2021

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Topics to Discuss

1. Introduction: Domestic and International Tax Changes Are Far-reaching
2. Beneficial Ownership Transparency
3. Digital Services Taxes
4. Base Erosion and Profit Shifting Rules
    a. Formulary Approach to Allocating Income for Tax Purposes
    b. Corporate minimum tax of 15%

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Beneficial Ownership Transparency

"To catch those who attempt to launder money, evade taxes, or commit other complex financial crimes, law enforcement, tax and other authorities need access to accurate and up-to-date data on the individuals who own and control Corporations".

- Federal Budget 2021 proposes to provide $2.1 million over two years to Innovation, Science and Economic Development Canada to support the implementation of a <u>publicly-accessible corporate beneficial ownership registry</u> by 2025.

- Currently, access can be requested by the Director under the *Canada Business Corporations Act*, any shareholder or creditor, so long as they are to use the information in connection with any matter relating to the affairs of the corporation- <u>not the general public</u>

- Ontario's Fall Budget proposes amendments to the *Business Corporations Act (Ontario)* to require disclosure of beneficial ownership to law enforcement, tax authorities and certain regulators, such as the Ontario Securities Commission, but <u>not to the general public</u>

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Digital Services Taxes

- In order to capture some of the untaxed revenue from the digital economy, several countries have introduced digital services taxes, and Canada has proposed doing so as well:
  - The U.K. introduced a diverted profits tax of 25% of profits deemed to be artificially diverted from the U.K. to a lower-tax jurisdiction
  - India introduced a 6% equalization levy
  - Germany, Spain, Austria and France introduced digital services taxes of 3%-5% on revenue

- The proposed Canadian DST would apply to large foreign and domestic entities (including corporations, trusts, and partnerships) or members of a group that meet both conditions:

  - €750 million or more in global revenue from all sources in the previous calendar year, and
  - in-scope revenue associated with Canadian consumers of $20 million (CAD) in that year

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Digital Services Taxes …cont'd

Canada proposes to impose a tax of 3% on Canadian-source revenue from:

- **online marketplaces** – including services provided through an online marketplace that helps match sellers of goods and services with potential buyers
- **social media** – including services provided through an online interface to facilitate interaction between users or between users and user-generated data
- **online advertising** – generally includes services aimed at the placing of targeted online advertising based on data gathered from users of an online interface
- **user data** – generally, the sale of data gathered from users of an online interface

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Base Erosion and Profit Shifting Rules

In order to forestall the proliferation of DST's on a per-country basis, with the resulting risk of double or triple taxation, the OECD has proposed a new approach to international taxation- a formulary approach to replace the "arm's length standard" in transfer pricing

- Under BEPS Action 1, Pillar 1, it was agreed to adopt new profit allocation and *nexus* rules so that 25% of large multinational enterprises' residual profits are redistributed to the countries in which consumers are located. Market jurisdictions would then have a taxing right over those residual profits.

- While this is a major shift away from the requirement for a physical *nexus* to confer jurisdiction to tax, in today's digital world with its absence of physical presence, there is a principled basis for shifting to a market-based approach.

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Base Erosion and Profit Shifting Rules … cont'd

The formula contains two computations, Amount A and Amount B

- Amount A applies to companies with global turnover above €20 Billion, and profitability above 10%. A new *nexus* rule permits allocation of Amount A to a market jurisdiction in which the relevant MNE derives at least €1 Million in revenue from that jurisdiction.

- For such an MNE, 25% of residual profit (defined as profit in excess of 10% of revenues) will be allocated to the relevant market jurisdiction.

- Amount B continues to apply the arm's length principle to in-country marketing and distribution activities only.

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Base Erosion and Profit Shifting Rules … cont'd

- What is more troubling, however, is Pillar 2, under which the group of 141 countries seeks to impose a 15% minimum corporate tax on large multinational enterprises (having annual revenues of at least €750 million).

- In the case of Canada, this would mean that a Canadian-based MNE would face an additional 15% tax on top of its regular corporate tax of 26.5%, to the extent that any foreign affiliate faced a local income tax of less than 15% in its home country.

- If the foreign affiliate paid income tax at the rate of, say, 5.5% in Barbados for example, the Canadian parent would get a credit for the 5.5% and pay 9.5% to Canada.

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Base Erosion and Profit Shifting Rules … cont'd

- The following information from the OECD itself refutes the claim that Canada (or for that matter any other member of the OECD) is suffering the loss of corporate tax revenue resulting from a so-called "race to the bottom", which purports to justify this new tax.

- The OECD's global corporate tax statistics database reports that average corporate tax revenues have risen from 12.3% of total revenues in 2000 to 15.3% in 2018. Corporate taxes collected as a per cent of GDP have increased from 2.7% to 3.2%- a gain of 20%.

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Base Erosion and Profit Shifting Rules … cont'd

- For over 46 years, Canadian international tax policy has been to foster capital export neutrality, so that an expanding Canadian firm can make its business decisions based on good business practices and not on lower taxes.

- The method for doing so was the establishment of an international tax system anchored in the creation of a notional account called "exempt surplus" in a foreign affiliate that carried on an active business in a country with which Canada has a tax treaty or a tax information exchange agreement.

- If that corporate group paid less tax on foreign earnings than would have been the case if it had only operated domestically in Canada that was seen as a positive result, permitting the Canadian-based multinational to compete and expand.

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Base Erosion and Profit Shifting Rules … cont'd

- This system also recognized that good international tax policy tries to reduce barriers to entry, and so if a Canadian-based MNE wished to expand into Europe, Canada would not impede its decision to run its active foreign affiliate through Ireland where the corporate tax rate was 12.5% versus Germany where the corporate tax rate was 30%.

- However, by imposing a minimum tax of 15% on this corporate group, the Government of Canada would be launching a direct assault against that positive international tax policy, without a justifiable rationale, as demonstrated by the OECD's own statistics.

- Such a policy constitutes a "soak the rich" tax grab, in the absence of real world, principled, fiscal policy justification, and would cause serious harm to Canada's corporate sector, to the detriment of all Canadians.

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Base Erosion and Profit Shifting Rules … cont'd

- The new international tax rules are intended to be implemented through a multilateral convention

- In order to be successful, the OECD must get the U.S. to approve and implement the necessary legislation, which may be a major stumbling block given the apparent deadlock in the U.S. Congress over tax reform

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Base Erosion and Profit Shifting Rules … cont'd

Media

- Diane Francis in the National Post, November 2, 2021: "Calming climate hysteria and bringing an end to tax cheats":
  - At the G20, U.S. President Joe Biden's breakthrough global minimum tax deal was inked by all members, for a total of 136 countries on board. This will revolutionize the world of business and geopolitics, and provide the United States, Canada and many other countries with a new source of much-needed revenues. It will also stop the "race to the bottom" on corporate taxation.
  - Now all multinationals will pay a minimum of 15% corporate taxes, including those that have dodged taxes for decades by routing funds and assets through trusts and bank accounts, and setting up fake offices in tax havens. Last year 55 major U.S. corporations – including household names like Nike and FedEx- paid virtually no taxes by playing these games, but that will soon come to an end.

  - Canadian multinationals do the same, mostly transferring profits to Luxembourg, Bermuda or Barbados. Their dodging will end now.

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Questions?

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