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# *Canada's Implementation of the Multilateral Convention to Prevent Base Erosion and Profit Shifting*

For the last several years, the Organization for Economic Cooperation and Development ("**OECD**") and G20 countries have worked on various action plans to address Base Erosion and Profit Shifting ("**BEPS**"). Of particular note has been the desire to update the bilateral tax treaty system (a) to relieve taxpayers from exposure to double taxation, (b) to eliminate opportunities for double non-taxation, and (c) to prevent taxpayers from inappropriately eroding tax bases and shifting profits from high-tax to low-tax jurisdictions.

Canada has now introduced legislation in Parliament to implement the *Multilateral Convention To Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the "**Convention**"), but with limitations and reservations.[1] It is intended that the Convention will operate alongside Canada's bilateral tax treaties,[2] but will only apply to a particular bilateral tax treaty if both parties agree and instruments of ratification are deposited with the OECD.[3]

Canada has agreed to modify the preamble to its tax treaties to include the following:

> *"Intending to eliminate double taxation with respect to taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or tax avoidance (including treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions).*[4]

Presumably, the hope of the Canadian government is that the courts will apply these principles when examining a tax plan, rather than concluding the opposite, such as has been the case in Canada, for example in the *MIL Investments* case.[5]

The most controversial provision contains a specific anti-abuse rule as follows:

> *"Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude; having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement."*

While Canada has adopted a detailed limitation-on-benefits provision in the Canada-U.S. Tax Convention ("**U.S. Treaty**") as a tool to combat perceived treaty abuse, and Canada has reserved the right to enact similar detailed rules in the future, the current template is to use a "principal purpose test". The major thrust of the criticism of

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[1] Bill C-82, Section 2, Schedule containing the Convention (the "**Schedule**").

[2] Of Canada's current list of 93 tax treaties in force, up to 75 are intended to be modified (**"Covered Tax Agreements**").

[3] The signatories to the Convention include most of Canada's significant trading partners, including the members of the European Union and China but not the U.S.A. The Convention currently has 86 signatory countries and came into effect on July 1, 2018, subject to the ratification process in each country.

[4] Article 6, paragraph 1 of the Schedule.

[5] *The Queen v. MIL Investments S.A.,* 2007 DTC 5437 (Federal Court of Appeal) where a general policy against treaty-shopping was rejected.

such a provision is the resulting uncertainty and scope for subjective judgements by the Canada Revenue Agency (**"CRA**"). In response, the CRA has announced that it is considering establishing an internal committee of tax experts, similar to the committee charged with evaluating General Anti-Avoidance Rule (**"GAAR**") cases, to consider situations where auditors propose to apply the principal purpose test to better ensure the consistency of its application.

In the Canadian government's announcement of implementing the Convention, they also indicated that the following new rules would be negotiated in its tax treaties:

- *a 365-day holding period for shares of Canadian companies held by non-resident companies. The holding period will ensure that the lower treaty-based rate of withholding tax on dividends will not be available to non-resident companies that engage in certain short-term share acquisitions;* and
- *a 365-day test period for non-residents who realize capital gains on the disposition of shares or other interests that derived their value from Canadian immoveable property. The test period will guard against certain transaction designed to obtain a treaty-based exemption from Canadian taxes on capital gains.*

A third announcement of note was made in respect of so-called "Dual Resident Entities". Originally, when Canada agreed to become a party to the Convention in May 2017, it reserved its right not to apply this provision, but now has reversed its position and is prepared to incorporate the Convention rules for resolving dual resident entity cases. The current Canadian position is reflected in Article IV-paragraphs 1 and 3 of the U.S. Treaty which provides that if a company is a resident of both countries, then it if it is created under the laws of one such country but not under the laws of the other country, it shall be deemed to be a resident only of the first-mentioned country. Failing such a situation, the competent authorities of both countries are to endeavour to settle the question of residency by mutual agreement, and in the absence of such agreement, the company shall not be considered a resident of either country for purposes of claiming tax treaty benefits.

In contrast, Article 4-paragraph 1 of the Convention provides in the case of a dual resident entity, a more subjective approach: the competent authorities are to endeavour to determine by mutual agreement the taxing jurisdiction for such person, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to the relevant tax treaty relief.

In addition, Article 4-paragraph 2 of the Convention provides that in the absence of specific rules in a Covered Tax Agreement that deal with dual resident companies or other entities, the provisions of Article 4-paragaph 1 of the Convention shall apply to resolve the matter. In other words, the conundrum of dual resident entities will no longer be resolved by objective tests, such as the place of incorporation, but rather the dual resident entity is left to have its fate determined in secret by the two tax authorities of the contracting states.

One other important set of provisions of the Convention that Canada has agreed to implement is the Mutual Agreement Procedure under Articles 16-26. Under these provisions, the contracting countries agree to resolve tax-treaty disputes through mandatory binding arbitration. This procedure, sometimes referred to as "baseball arbitration", similar to the rules in the U.S. Treaty, contemplate that when the two competent authorities cannot come to an agreement, each side presents its final offer to a panel of arbitrators, and only one offer is accepted with no additional reasons for the choice.

Canada has made reservations on numerous other provisions of the Convention, two of which are as follows:

- Article 3 on transparent or hybrid entities which endeavours to ensure consistent cross-border treatment of entities in the two tax treaty jurisdictions. Canada has adopted complex rules in the U.S. Treaty which have not been repeated elsewhere, and so this reservation may signal a position of Canada to move very cautiously on this front;
- Articles 10, 12, 13, 14 and 15 dealing with expanding the permanent establishment rules to determine when a host country can tax the profits of a non-resident carrying on business in the jurisdiction. Canada now considers itself a capital exporting country and so views an expanded permanent establishment rule as detrimental to Canadian-based multinationals.

On the assumption the Convention is ratified in 2018, the earliest its provisions could apply to Canada's tax treaties with treaty partners that have also ratified the Convention is January 1, 2020 for withholding taxes, and for all other taxes for tax years beginning after June 30, 2019.

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