

Canada begins ratification process for multilateral tax convention to implement BEPS

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- Canada began its domestic procedures to ratify the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI) on January 31, 2018
- The MLI will modify a significant number of existing bilateral tax treaties, including up to 75 of Canada's Covered Tax Agreements
- The most significant modification will be to add a broad anti-avoidance rule
- Overview of when the MLI is expected to come into effect for particular Covered Tax Agreements
- A discussion on recent OECD commentary relevant to the MLI

The OECD's [Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting](#) [PDF] was tabled in the House of Commons on January 31, 2018. This is the first step in the process for Canada to ratify the MLI, which it signed in June 2017.

The MLI has been signed by 78 jurisdictions (including Canada). Once in effect, the MLI will modify a significant number of existing bilateral tax treaties, including up to 75 of Canada's bilateral tax treaties (referred to as Covered Tax Agreements – [view a full list](#) [PDF]). The most significant modification will be to add a broad anti-avoidance rule into these tax treaties, referred to as the principal purpose test or PPT. Under the PPT, a treaty benefit may be denied where it is reasonable to conclude that one of the principal purposes of an arrangement or transaction is to gain the benefit unless it is established that granting the benefit would be in accordance with the object and purposes of the relevant provisions of the treaty. Other important modifications under the MLI include improving dispute resolution (including expanding the use of binding arbitration) and a potential expansion of the "permanent establishment" threshold.

Timeline for MLI coming into effect

The MLI will come into effect for a particular Covered Tax Agreement after the domestic ratification procedures are completed in both Canada and the jurisdiction of the relevant treaty counterparty. The Canadian ratification procedures are as follows:

(i) the MLI must be tabled for 21 sitting days of Parliament (which commenced on January 31, 2018, and is expected to be completed around March 22, 2018)

(ii) a bill must then be introduced to implement the MLI into Canadian domestic law (the Implementation Bill), which will need to be debated in both the House of Commons and the

Senate, with both houses likely sending the Implementation Bill to committee for study

(iii) the Implementation Bill must be approved by Parliament and receive Royal Assent

(iv) an Order in Council is then needed to notify the OECD that the ratification procedures in Canada are complete

For Covered Tax Agreements, the MLI will enter into *force* on the first day of the month beginning three months after Canada and the relevant treaty partner complete their notifications to the OECD and it will enter into *effect* for (a) withholding taxes, on the first day of the next calendar year, and (b) for other taxes, for tax years beginning six months after the MLI enters into force. To date, only Austria, Isle of Man, Jersey and Poland have notified the OECD that their ratification procedures are complete.

By way of example, if both parties to a Covered Tax Agreement notified the OECD in August of 2018 that its domestic ratification procedures were complete, the MLI would enter into force for the relevant Covered Tax Agreement on December 1, 2018. The MLI would then enter into effect for that Covered Tax Agreement (a) for withholding taxes, on January 1, 2019, and (b) for other taxes, for tax years beginning on or after June 1, 2019.

Recent OECD commentary relevant to the MLI

The purpose of the MLI is to allow quick implementation of tax measures contained in the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. On signing the MLI, Canada agreed to adopt the minimum standards agreed to in BEPS (the PPT anti-avoidance rule, an amended tax treaty preamble and dispute resolution procedures, including potential binding arbitration) and chose to reserve on various other MLI provisions (including the expansion of the permanent establishment threshold). [View a full list \[PDF\]](#) of Canada's provisional positions on the MLI.

On November 21, 2017, the OECD released its latest update to the [OECD Model Tax Convention](#) (the OECD Model). The various BEPS provisions in the MLI have now been included in the OECD Model. As such, the OECD Model and its commentary provides insight into Canada's potential interpretation of the minimum standards (which it has already agreed to), as well as the other provisions of the MLI (should Canada withdraw any of its current reservations).

Article 29 of the OECD Model includes a limitations-on-benefits rule and will now include the MLI's PPT rule. As such, the OECD Model provides commentary on tax avoidance and the PPT, which may be relevant for the purposes of interpreting the MLI. The OECD Model commentary asserts that the inclusion of an express PPT in the OECD Model merely confirms a general principle that was already implicit in previous versions of the OECD Model. While that assertion appears inconsistent with the Federal Court of Appeal's decision in *MIL Investments*, it may be more relevant when applied to a Covered Tax Agreement that includes an amended preamble referring to an intent not to create opportunities for reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements). The OECD Model commentary further notes that, as a general rule, there should not be a conflict between the PPT and domestic anti-avoidance rules (e.g., Canada's general anti-avoidance rule or GAAR, in section 245 of the *Income Tax Act* (Canada)). Given this view, consistent with GAAR jurisprudence, when the PPT is at issue the Crown ought to have the onus of proving that a transaction contravenes the object or purpose of the particular tax treaty.

As noted, Canada has reserved on the expansion of the PE threshold in the MLI; however, it is possible that Canada may change its preliminary MLI positions prior to completing its

domestic ratification process. Interestingly, Canada did not reserve on the expansion to the permanent establishment definition in article 5(5) of the OECD Model. Article 5(5) of the OECD Model provides a state the right to tax an enterprise in certain situations where the enterprise may not have a fixed place of business in that state. Subject to the independent agent exception, article 5(5) provides that an enterprise will be found to be participating in a business activity (and thus have a permanent establishment) in a state where any person is (i) habitually concluding contracts in the name of the enterprise; (ii) habitually concluding contracts that are to be performed by the enterprise; or (iii) habitually playing the principal role leading to the conclusion of contracts, which are routinely concluded without material modification by the enterprise. The OECD Model commentary takes the position that where this occurs, the person's actions would go beyond "mere promotion or advertising" and result in the conclusion of contracts in the particular state.

Although Canada did not reserve on article 5(5) in the OECD Model, it is hoped that Canada will continue to reserve on its equivalent provisions in the MLI. In particular, adopting these changes in Canada's tax treaties could significantly increase the number of situations in which permanent establishments arise, which in turn could result in increased compliance and administrative costs due to additional tax reporting requirements. Such a change could also adversely affect the Canadian tax base. In particular, where Canadian resident corporations are considered to have permanent establishments in other jurisdictions, Canada is generally required to provide a tax credit in respect of foreign taxes levied on income of a corporation resident in Canada that is attributable to a foreign permanent establishment.

For further background on the MLI – including a discussion of the [OECD's BEPS Final Report](#) (which includes recommendations on the MLI and 14 other action items), optional provisions of the MLI and Canada's implementation procedures – see our Osler Updates "[International Tax Reform 2015 – BEPS Final Report](#)," "[Significant tax treaty changes proposed in multilateral convention](#)," "[Canada signs the multilateral tax agreement](#)" and "[New PPT rule in the OECD's Multilateral Instrument to displace Canadian GAAR?](#)".

For further information on the MLI, the PPT or other tax matters, please contact any member of our [National Tax Group](#).