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Update on implementation of the Multilateral Instrument in Canada

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Canada signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting [PDF] — also known as the Multilateral Instrument or MLI — in June 2017, and subsequently commenced its domestic process to ratify the MLI in June 2018 by tabling Bill C-82, *An Act to implement a multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting* in the House of Commons.

Current status of MLI implementation in Canada

Bill C-82 is currently in its third reading in the House of Commons — having been approved without revision by the House of Commons Standing Committee on Finance. In order for Canada to complete its domestic ratification procedures with respect to the MLI, Bill C-82 must be approved by the House of Commons, and debated, studied and approved by the Senate. Following passage of the bill through both the House of Commons and the Senate, Bill C-82 must receive royal assent. An Order in Council is then required to notify the OECD that the ratification procedures in Canada are complete.

The last sitting days of the House of Commons and the Senate prior to the 2019 parliamentary summer recess are scheduled to be on June 21 and June 28, respectively. Following summer recess, the House of Commons and the Senate are scheduled to return on September 16, 2019. However, in light of the upcoming federal election, which must occur on or before October 21, 2019, it is likely that the House of Commons and the Senate will not return from summer recess until after the election, at which time all bills that have not been passed prior to the election will need to be reintroduced.

The MLI will enter into force for Canada on the first day of the month beginning three months after Canada deposits its instrument of ratification with the OECD. Therefore, in order for the MLI to enter into force for Canada on or before January 1, 2020, it is likely necessary for Bill C-82 to be approved by both the House of Commons and the Senate by the last sitting day of these respective houses in June 2019. In the absence of such approval by June 2019, the legislative process with respect to the MLI will likely need to be restarted following the 2019 federal election.

Timeline for MLI to enter into effect for Canada’s tax treaties

Where the MLI is already in force for a counterparty to a Covered Tax Agreement, the MLI will enter into *effect* for that Covered Tax Agreement (i) for withholding taxes, on the first day of the “next calendar year that begins on or after” the date on which the MLI enters into force for Canada, and (ii) for other taxes, for tax years beginning six months after the MLI enters into force for Canada. Where the MLI is not yet in force for a counterparty, the timeline for entry into effect for that Covered Tax Agreement will depend on the date on which the MLI enters into force for that counterparty.

Twenty-five other signatories to the MLI have already deposited their respective instruments of ratification with the OECD (including Australia, France, Ireland, Luxembourg, Netherlands, Singapore and the United Kingdom). Therefore, the date on which the MLI will enter into effect for Canada's tax treaties with those countries will depend solely on the date on which Canada deposits its instrument of ratification with the OECD.

There is some ambiguity in the words "next calendar year that begins on or after" a certain date, in circumstances where the MLI enters into force for a country on the first day of a calendar year. This ambiguity applies, for example, if Canada deposits its instrument of ratification with the OECD in September 2019 — and the MLI enters into force for Canada on January 1, 2020. The OECD and the Canadian Department of Finance have indicated that in this scenario (and assuming that the MLI is already in force for a counterparty), the MLI will enter into effect for withholding taxes on January 1, 2020 (i.e., the same date as Canada's entry-into-force date), rather than January 1, 2021 (i.e., the "next" calendar year).

However, if Canada deposits its instrument of ratification with the OECD after October 1, 2019 (e.g., if the legislative processes for Bill C-82 are not completed before the 2019 federal election), the earliest time at which the MLI could enter into force for Canada would be sometime in 2020. In that case, the MLI would enter into effect for applicable Covered Tax Agreements (including those with the countries listed above) (i) with respect to withholding taxes, beginning January 1, 2021 at the earliest, and (ii) with respect to other taxes (such as taxes on capital gains), for taxation years beginning six months after the MLI entered into force for Canada, which for calendar-year taxpayers would be taxation years beginning on January 1, 2021, at the earliest.

Additional background on the MLI

The most significant treaty modifications to be implemented through the MLI will be the addition of a broad anti-avoidance rule into Covered Tax Agreements, 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 was to gain such 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 minimum standards to be implemented through the MLI include (i) an amended preamble, suggesting that Covered Tax Agreements are intended to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, and (ii) modified dispute resolution procedures, including the adoption of mandatory arbitration procedures. These minimum standards are described in more detail in the Osler Updates "Canada signs multilateral tax agreement" and "New PPT rule in the OECD's Multilateral Instrument to displace Canadian GAAR?"

In May 2018, Canada also announced its intention to remove its initial reservations on some of the optional MLI provisions, including (i) the addition of a one-year holding period test to access treaty-based withholding tax reductions on dividends received by corporations, (ii) the addition of a one-year lookback test to determine whether capital gains on a sale of equity interests derive their value principally from immovable property for purposes of a Covered Tax Agreement, and (iii) the addition of certain factors to be considered by competent authorities when resolving cases of dual residency for entities. These optional MLI provisions, which are expected to be adopted once the MLI enters into effect for Canada's Covered Tax Agreements, are described in more detail in the Osler Update "Canada tables NWMM to ratify MLI; Updates MLI reservations."

For further background on the MLI, see our Osler Updates "Canada begins ratification process for multilateral convention to implement BEPS" and "Significant tax treaty changes proposed in multilateral convention."

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