

June 7, 2017

Canada signs multilateral tax agreement

Canada and 67 other jurisdictions signed the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (referred to as the multilateral instrument or MLI) on June 7, 2017, at a signing ceremony in Paris. An additional eight countries have formally indicated an intention to sign. As a result, the MLI signatories will include most of Canada's significant trading partners (including the United Kingdom, all members of the European Union, and China), but will not include the United States. The United States was not expected to sign given prior concerns raised by U.S. officials about the MLI. A full list of signatories is available [here](#) [PDF]. The OECD expects that there will be approximately 100 signatories by the end of this year.

The MLI's purpose is to implement certain tax treaty measures contained in the [OECD/G20 Base Erosion and Profit Shifting \(BEPS\) Project](#) in an expedient and predictable manner. For further details on BEPS, see our Osler Update, "[International Tax Reform 2015 – BEPS Final Report](#)". The MLI is not a stand-alone tax treaty, but rather modifies existing bilateral tax treaties where each bilateral treaty partner has ratified the MLI and has notified the OECD that the MLI applies to the treaty. Such bilateral tax treaties are referred to as Covered Tax Agreements.

Canada has listed 75 of its 93 tax treaties as Covered Tax Agreements, which will be affected by the MLI if Canada and the relevant Covered Tax Agreement partner ratify the MLI under their respective domestic laws. A list of Canada's Covered Tax Agreements is available [here](#) [PDF]. Based on the June 7 signatories, the MLI could affect approximately 1,100 bilateral tax treaties. In some cases, Canada may continue to seek to amend tax treaties through bilateral negotiations, rather than through the MLI. For example, Canada's tax treaties with Germany and Switzerland are not listed as Covered Tax Agreements, although Canada announced that it will be holding bilateral negotiations with each of those countries later this month.

The MLI requires that signatories agree to certain minimum standards developed under the BEPS Project. The BEPS minimum standards covered by the MLI relate to anti-treaty shopping rules and dispute resolution and mutual agreement procedures (MAP) measures. There is some flexibility regarding how the minimum standards will be satisfied. There is also flexibility with respect to the potential application of various other BEPS measures contained in the MLI that are not minimum standards. This flexibility is offered by way of the ability to register a reservation on a particular MLI measure. A full list of Canada's provisional reservations is available [here](#) [PDF].

Canada has registered provisional reservations on all of the provisions of the MLI, other than the minimum standards relating to anti-treaty shopping and the optional provision related to binding arbitration. Canada will consider the possible application of the other MLI provisions between now and the time of ratification (at which time the final list of reservations must be provided). Following ratification, no further reservations may be registered, although signatories may withdraw or narrow a reservation following ratification.

The MLI's effective date depends on the timing of domestic ratification procedures. However, a Canadian Department of Finance official has speculated, based on reasonable assumptions regarding the timing of the domestic ratification procedures, that the MLI could come into force with respect to Canada's Covered Tax Agreements as early as January 1, 2019 (for withholding taxes) and (for all other taxes) for taxable periods beginning after June 1, 2019.

For further background on the MLI – including a discussion of the optional provisions of the MLI for which Canada has registered provisional reservations – and for a detailed discussion of the implementation procedures, see our Osler Update [“Significant tax treaty changes proposed in multilateral convention”](#).

Below, we have summarized Canada's position with respect to the BEPS minimum standards set out in the MLI.

Anti-treaty shopping rules

To implement one of the BEPS minimum standards, the MLI will amend the preamble of Canada's Covered Tax Agreements to note an intention for tax treaties to eliminate double taxation without creating opportunities for non-taxation (or reduced taxation) through tax evasion or avoidance. These changes to the preamble of Canada's Covered Tax Agreements could be relevant, for example, in determining whether Canada's domestic general anti-avoidance rule (GAAR) applies in perceived treaty shopping situations.

In addition, the BEPS minimum standard to prevent treaty shopping requires a signatory to the MLI to agree to prevent certain abusive treaty shopping arrangements through (a) a principal purpose test (PPT), (b) a comprehensive limitation-on-benefits (LOB) rule combined with an anti-conduit rule, or (c) both a PPT rule and a LOB rule.

Canada has confirmed that it will adopt a PPT rule into its Covered Tax Agreements as an interim measure, intending where possible to adopt an LOB provision (in addition to or in replacement of the PPT rule) through bilateral negotiations. As such, once the MLI comes into effect for Canada's Covered Tax Agreements, a tax treaty benefit will be denied where one of the principal purposes of an arrangement or transaction is to, directly to indirectly, obtain the benefit, unless granting the benefit would be in accordance with the object and purpose of the Covered Tax Agreement. Unfortunately, the broad wording of the PPT, together with the limited interpretive guidance provided by the OECD to date, will result in uncertainty regarding whether treaty benefits will apply in a variety of situations. See, for example, our Osler Update, [“Are private equity and other collective investors entitled to tax treaty benefits?”](#)

The PPT rule will only apply to Canada's Covered Tax Agreements, and not to Canada's other tax treaties. For example, the PPT rule will not apply to Canada's tax treaty with the United States (although that treaty already has a comprehensive LOB rule).

In order to enforce the BEPS minimum standard, a peer review and monitoring process will be implemented as early as June 2018. The monitoring process will address whether the minimum standard has been incorporated in existing bilateral treaties by requiring each jurisdiction to participate in an annual review. Each jurisdiction will analyze the effect of the MLI on each of its applicable tax treaties, thus instilling a peer review of compliance. The findings will be processed by the Inclusive Framework on BEPS and presented at their annual meeting, beginning in January 2019.

Dispute resolution – MAP and binding arbitration

The MLI implements the BEPS minimum standard for resolving treaty-related disputes. Specifically, signatories must agree to fully implement MAP, which requires the competent authorities of each jurisdiction to attempt to resolve certain disputes in a timely manner (i.e. within three years of competent authorities' notification). A taxpayer will be eligible for MAP where the taxpayer considers the actions of one, or either, of the relevant jurisdictions will result in taxation which is not in accordance with the provisions of the Covered Tax Agreement. While

the MLI will modify the MAP procedures in Canada's Covered Tax Agreements, certain existing provisions in those agreements will remain. For example, many of Canada's tax treaties will continue to provide for a period that is shorter than the three-year period contemplated in the MLI.

Canada and 24 other jurisdictions have opted into the mandatory arbitration procedures under the MLI. The default under this rule is "final offer" arbitration (i.e. "baseball arbitration"), similar to the rule in the Canada-U.S. treaty. The arbitration provisions of the MLI were largely influenced by the Canada-U.S. Treaty, and as such, will be largely familiar to Canadian taxpayers.

Under the "final offer" model, when two jurisdictions cannot come to an agreement within a specified period, the matter will be submitted to mandatory binding arbitration. An arbitration panel will then choose one of the proposed resolutions offered by the respective competent authorities. The decision will be adopted by a simple majority of the panel and no additional reasons will be provided to the taxpayer.

Where one of Canada's treaty partners has not opted in to the MLI arbitration provisions, these provisions will not apply to the Covered Tax Agreement. The arbitration provisions of the MLI have "free-form reservations," which means that it is up to the relevant countries to define the scope of the issues they are willing to submit to arbitration. As a result, the details regarding arbitration may vary between each Covered Tax Agreement.

The MLI, and the BEPS project more broadly, may adversely impact the tax treatment of many cross-border transactions and arrangements. As a result, taxpayers should carefully review the manner in which the MLI or other BEPS measures may impact them.

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