Osler, Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario, Canada M5X 1B8
416.362.2111 MAIN
416.862.6666 FACSIMILE

OSLER

Toronto

Montréal

Calgary

Ottawa

Vancouver

New York

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SENT BY ELECTRONIC MAIL (Consultation-Legislation@fin.gc.ca)

Department of Finance Canada
Tax Policy Branch
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Sirs/Mesdames:

RE: Submission on the Global Minimum Tax Act

This submission is in response to the draft legislative proposals in the *Global Minimum Tax Act* ("**GMTA**") released on August 4, 2023, that, if enacted, would implement a global minimum tax ("**GMT**") in connection with Canada's membership in the OECD/G20 Inclusive Framework on BEPS (the "**Inclusive Framework**").

The GMTA implements in Canada two key GMT measures, namely:

- an income inclusion rule ("**IIR**") in respect of qualifying multinational enterprise ("**MNE**") groups' low-taxed entities located outside of Canada that is intended to be a qualified IIR; and

- a domestic minimum top-up tax in respect of the qualifying MNE group's low-taxed entities located in Canada that is intended to be a qualified domestic minimum top-up tax ("**QDMTT**").

The GMTA is also proposed to include provisions to implement the undertaxed profits rule ("**UTPR**"), which are expected to be released at a later date.

Consistent with the Pillar Two proposals, the GMTA introduces a 15% GMT on the income of large MNEs that have annual consolidated revenues of EUR 750 million or more and a business presence in at least one foreign jurisdiction. We note that many major economies (including the United States, China and others) are unlikely to implement the Pillar Two framework in 2024. However, Canada has proposed for the GMTA to be effective for fiscal years beginning on or after December 31, 2023.

Our submission is focused on the proposed implementation and technical considerations related to the implementation of the GMT within the Canadian legal and income tax

context. In particular, we are not commenting here on the broader tax policy aspects of Pillar Two although we have previously provided comments on Pillar Two to the OECD.[1]

We understand that the timeline to implement Pillar Two is politically motivated. However, important aspects of the rules have not yet been finalized or published by the Department of Finance or the Inclusive Framework. In particular, in our view it is critical for each of the following to occur before the date on which the GMTA becomes effective:

1. The Inclusive Framework should complete any remaining work on the design and operation of the OECD GloBE model rules released on December 20, 2021 ("**GloBE model rules**"), including changes to the commentary on the GloBE model rules ("**GloBE commentary**") and the administrative guidance agreed to by the OECD/G20 Inclusive Framework;

2. The GMTA should be amended to fully reflect the final GloBE model rules, commentary and administrative guidance, including all relevant aspects of the second round of administrative guidance that have not yet been reflected in the GMTA;

3. The Department of Finance should release the requisite changes to the *Income Tax Act* (the "**ITA**") related to the GMTA (as discussed further below); and

4. The Department of Finance should release detailed Explanatory Notes to the GMTA to allow taxpayers to comply with the GMTA, and for the Canada Revenue Agency ("**CRA**") to administer the GMTA, in a consistent manner.

If each of the above are not completed in a timely manner, then we believe the Department of Finance should delay the coming-into-force date of the GMTA until such completion. Taxpayers (and the CRA) must be able to fully understand precisely how the GMTA (and the related rules in the ITA) will operate before they are required to begin complying with such rules. It is not sufficient to suggest that there is enough time because the filing deadline for the first year subject to the GMTA will be 18 months after the end of the fiscal year. Taxpayers need to be able to understand and assess the impact of the rules as of their effective date to appropriately structure their affairs, and to properly disclose any resulting impact in their financial statements.

[1] See Osler submission on the OECD Pillar One and Pillar Two Blueprints (December 14, 2020) and Osler submission to OECD on the Global Anti-Base Erosion Proposal (December 3, 2019).

1. Translation of GloBE sources and section 3 of the GMTA

Canada did not take the approach of incorporating the GloBE model rules by reference or adopting the GloBE model rules and "global" terminology from the GloBE sources in their entirety. The draft GMTA largely follows the substance of the GloBE sources, but the structure is different. The GMTA also incorporates important aspects of the GloBE commentary and administrative guidance directly in the domestic legislation implementing Pillar Two that are not in the GloBE model rules themselves. Finally, the GMTA follows Canadian drafting conventions rather than the language of the GloBE model rules.

For example, the GloBE model rules provide for a GloBE Information Return ("**GIR**") based on a template approved by the Inclusive Framework on July 13, 2023 (Article 8.1.4. of the GloBE model rules) using definitions contained in the approved template (Article 8.1.5. of the GloBE model rules). The GIR template reflects many definitions from the GloBE model rules, some of which are different from the definitions in the GMTA. For instance, the GMTA uses the defined terms "top-up amount" and "financial accounting income"[2] while the GloBE model rules use the defined terms "top-up tax" and "financial accounting net income or loss". The GMTA also does not include the definition "net GloBE Income or Loss" that is present in both the GloBE model rules and the GIR template and instead uses two separate defined terms: "net GloBE income" and "net GloBE loss".

The Canadian approach risks translation errors when incorporating provisions from the relevant GloBE sources. This approach also heightens the risk that certain aspects of the GMTA could be interpreted or applied differently than in other jurisdictions.

There is inevitable tension between the Canadian approach and the ambulatory reference in section 3 of the GMTA to the various GloBE sources, as those are amended from time to time. Section 3 provides that certain parts of the GMTA (including the parts implementing the IIR and UTPR) are to be interpreted consistently with the GloBE sources unless the context otherwise requires. This ambulatory reference (i.e., as amended from time to time) appears intended to ensure that future changes to the GloBE sources will apply in Canada once adopted by the OECD. The Governor in Council can also designate additional sources through regulation.

Future amendments to these GloBE sources will not automatically be translated or adapted to the "Canadianized" iteration of the GMT in the GMTA. However, section 3 purports to give effect to these sources in a language that is "global". Given the approach Canada has taken in implementing Pillar Two, and the ambulatory reference in section 3, it is imperative that the Department of Finance provide comprehensive guidance regarding

[2] We note that the term "financial accounting income" could cause confusion since it includes both financial accounting income and financial accounting loss.

current and subsequent versions and changes to the GloBE sources. Taxpayers should not be left trying to decipher the implications of subsequent "global" versions and changes to the GloBE model rules to the already "Canadianized" GMTA.

More importantly, to the extent future amendments to the GloBE sources referenced in section 3 could result in an additional amount of tax owing by any person under the GMTA, this interpretive rule appears to be an unlawful delegation or subdelegation of Parliament's authority to impose taxes to the OECD or the Inclusive Framework. We encourage the Department of Finance to reconsider the appropriateness of such an ambulatory reference to OECD/Inclusive Framework publications in the GMTA and in substantive tax legislation. Instead, we suggest that the Department of Finance introduce amendments to the GMTA, the ITA or any related Explanatory Notes in a timely manner when and if it is considered desirable to do so. In any event, the GMTA should clarify that, consistent with the Federal Court of Appeal decision in *Prévost Car*,[3] any changes to the administrative guidance will not have retroactive effect in Canada unless and to the extent that such changes are merely clarifying in nature.

In addition, the Department of Finance should implement a mechanism to assist Canadians in seeking further amendments or clarifications to the GloBE model rules and related commentary. Through Canada's membership in the Inclusive Framework, the Department of Finance is better positioned than taxpayers to influence any future changes or clarifications that may be required. In particular, unintended consequences will inevitably arise as a result of the unique and global nature of the GMTA and the GloBE model rules. It is critical that Finance actively lobby on behalf of Canadian taxpayers and the interests of Canada when changes or clarifications to the GloBE model rules and commentary are in their respective interests. For example, Department of Finance should provide clear instructions to Canadian taxpayers (and the CRA) with respect to the manner in which they can provide on-going feedback and comments related to the GMTA and the GloBE sources. Moreover, the Department of Finance should promptly consider such feedback, and timely advocate on behalf of Canadian taxpayers (and Canada) to ensure that future changes or clarifications are made to the GloBE model rules and commentary that are in our respective interests.

Similarly, we would encourage the Department of Finance to confirm that the CRA will be willing to provide advance tax rulings specifically related to the application of the GMTA based on similar procedures under the ITA.

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[3] *Prévost Car Inc. v. Canada*, 2009 FCA 57 at paras 11-12.

2. Interaction with the GAAR in the ITA

Section 52 of the GMTA provides that the general anti-avoidance rule ("**GAAR**") in section 245 of the ITA will apply to the determination of any amount under the GMTA, with necessary modifications. As the GMTA is intended to be consistent with the GloBE model rules, any anti-avoidance rules in the GMTA should mirror those used in the GloBE model rules. This is the only way to adequately ensure consistency of outcomes and approach across the various members of the Inclusive Framework. Allowing countries to adopt their own unilateral approach to anti-avoidance rules in adopting Pillar Two risks material uncertainty in application and outcomes under Pillar Two. As a result, in our view section 52 should be deleted from the GMTA. In the event that the Inclusive Framework determines that additional anti-avoidance rules are necessary, Canada should make corresponding changes at that time.

3. Intra-group financing arrangements

The marginal note for subsection 18(16) of the GMTA describes the limit on expenses attributable to intra-group financing arrangements as an "anti-avoidance" rule. However, the provision lacks any avoidance threshold or purpose test in its application. Under subsection 18(6), intra-group financing expenses of a low-taxed constituent entity are excluded from the calculation of GloBE income or loss of a low-taxed constituent entity if they are reasonably expected not to be included in the taxable income of a high-tax counterparty over the duration of the arrangement. The text of the current wording could lead to anomalous and unintended consequences. For example, it appears that the proposed text could apply to deny expenses in a low-taxed constituent entity merely because a high-taxed constituent entity happens to have losses or other tax attributes – even if such losses or other tax attributes are unrelated to the amount paid by the low-taxed constituent entity. The Department of Finance should amend paragraph 18(16)(b) of the GMTA, or at a minimum clarify in the accompanying Explanatory Notes, that this provision will not apply in ordinary commercial situations that should not be considered abusive (regardless of whether a particular income inclusion may be offset or netted against a particular deduction or credit).

4. Definition of "passive income"

Article 10.1 of the GloBE model rules includes a definition of "passive income" that is relevant for determining the amounts of covered taxes allocated to constituent entities from their direct or indirect foreign shareholders in certain situations. The GMTA refers to passive income in the relevant GMT computations, but does not define the term. The term "passive income" should be defined in the GMTA in a manner that is consistent with the GloBE definition of "passive income" to ensure consistency with the GloBE model rules.

5. Inclusion of payments in lieu of taxes in covered taxes

The Department of Finance should make clarifying amendments to paragraph 23(1)(c) or confirm in the Explanatory Notes that payments made by Canadian tax-exempt entities in lieu of federal and provincial corporate taxes ("**PILs**") will be "covered taxes" for GMTA purposes. We would expect these payments to be included in covered taxes, as they "are imposed in lieu of an income or profits tax of general application". The general reference to "taxes" in the preamble of subsection 23(1) should not displace this result for PILs, which are made in lieu of federal and provincial corporate taxes.

6. Design of investment tax credits

The treatment of credits under Pillar Two primarily depends on their refundability and qualified status. Qualified refundable credits are generally afforded more favourable treatment since they are included in GloBE income and do not reduce covered taxes. This generally results in a higher effective tax rate ("**ETR**") than would arise in respect of non-qualified refundable credits and non-refundable credits that are not included in GloBE income but reduce covered taxes. As a result, MNEs with non-qualified refundable credits and non-refundable credits will generally have a lower ETR due to the reduction in covered taxes, while those with qualified refundable credits will generally experience a higher ETR as the credits do not reduce covered taxes.

The Department of Finance should consider the impact of Pillar Two on domestic tax incentives and evaluate whether it is possible to cause more Canadian tax credits, including SR&ED tax credits, to be qualified refundable credits from a GMT perspective (or convert such amounts into grants). Moreover, if the policy objectives of Canada's tax credit regimes are partially frustrated by increased Canadian QDMTT taxes, then Canada should consider making such tax credit regimes correspondingly more attractive (e.g., by increasing the amount or expanding the circumstances in which such credits will be provided).

It would also be helpful for the Department of Finance to include specific examples in the Explanatory Notes to the GMTA to illustrate the manner in which Canada's QDMTT will apply to common Canadian tax credits.

Going forward, we recommend that future investment tax credits be designed to fall within the meaning of qualified refundable tax credits for purposes of the GMTA and the GloBE model rules.

7. Implementation of second administrative guidance

In the news release that accompanied the draft GMTA, the Department of Finance acknowledged that certain important aspects of the second administrative guidance

published by the OECD on July 13, 2023 were not included in the GMTA. The Department of Finance indicated its intention to revise the GMTA to reflect these missing aspects, including on the treatment of transferable and other tax credits.

This subsequent revision should include the following two key aspects of the second administrative guidance:

a) Rules regarding the GMT treatment of "marketable transferrable tax credits", "non-marketable transferrable tax credits" and "other tax credits" (consistent with the second administrative guidance); and

b) An alternative timing rule where an MNE uses the proportional amortization method of accounting for a qualified ownership interest and can therefore use the same methodology for purposes of determining whether and to what extent flow-through tax benefits reduce the investment cost basis or adjusted covered taxes, as the case may be. It is also important that the revised rules enable MNEs that do not use the proportional amortization method of accounting in the described situations to make an election to apply this methodology for GMT purposes and in line with the second administrative guidance.

8. Treatment of common US taxes and credits

It would be helpful for the Department of Finance to include specific examples in the Explanatory Notes to clarify the treatment under the GMTA of common US taxes and credits given that the United States is Canada's largest trading partner. Such examples should include common taxes that may be paid by a US subsidiary of a Canadian parent, including ordinary federal, state and local corporate income taxes, global intangible low-taxed income ("**GILTI**") taxes, Subpart F taxes (on either "passive income" or other income), and the 15% corporate alternative minimum tax. In addition, such examples should include common US tax credits, including transferrable investment tax credits and tax credits and benefits that fall within the definition of Qualified Flow-Through Tax Benefits as described in the GloBE administrative guidance.

9. Application of the QDMTT safe harbour

Section 43 includes a QDMTT safe harbour that deems the top-up amount of a particular constituent entity of (or a particular joint venture entity in respect of) an MNE group to be nil if four requirements listed in the section are met.

The second requirement is met where "the jurisdiction's qualified domestic minimum top-up tax has qualified domestic minimum top-up tax safe harbour status for the fiscal year as determined by the Inclusive Framework and published on the Internet website of the OECD."

Many MNEs (including those that are publicly listed) are required to prepare quarterly consolidated financial statements that include estimates of tax liabilities, including GMT liabilities.

It is possible that that the Inclusive Framework will not be able to undertake and finalize a peer review process in respect of all (or even most) jurisdictions that intend to introduce a QDMTT in a timely manner. As a result, the OECD may not be able to publish a list of jurisdictions that have QDMTT safe-harbour status in a timely manner. In that case, MNEs may need to undertake complex GloBE computations to estimate the top-up amount for jurisdictions (e.g., for purposes of their quarterly financial reporting) even if it is likely that no top-up amount would be payable for the jurisdiction once the Inclusive Framework finalizes its QDMTT peer review process.

This issue could be mitigated if the GMTA transitional rules are revised to provide that any domestic regime that is intended to qualify as a QDMTT is presumptively assumed to have qualifying QDMTT safe-harbour status unless and until the OECD peer review process determines that it does not.

10. ITA integration rules

In anticipation of the ITA integration rules that the Department of Finance is considering, it is important to consider the necessary amendments to the foreign accrual property income ("**FAPI**") and surplus regimes in the ITA and Regulations. In particular, it will be important to avoid multiple layers of taxation through appropriate adjustments to key provisions in the ITA and Regulations to properly integrate with the GMTA and GloBE model rules. In particular, consideration should be given to the following:

- the inclusion in the definitions of "foreign accrual tax" in ITA 95(1) and "underlying foreign tax" in Regulation 5907(1) of (i) any QDMTT paid by a particular foreign affiliate (or other relevant affiliate), and (ii) IIR or CFC taxes paid in respect of the income of a particular foreign affiliate; and

- an increase to the adjusted cost base of shares of each relevant foreign affiliate to take into account IIR or CFC taxes paid in respect of the income of a particular foreign affiliate.

In addition, there is currently no efficient way for a foreign affiliate to reimburse its Canadian parent for any top-up tax amount that may be paid in respect of the affiliate's low-taxed income under the GMTA. For example, if a foreign affiliate has active business income that is not taxed locally then the Canadian parent may pay a 15% GMT under the IIR. In that case, it may be appropriate commercially for the foreign affiliate to reimburse the Canadian parent for such taxes (particularly in the case where there are minority shareholders). The ITA and Regulations should be amended to clarify that no benefit will

be considered to have been conferred as a consequence of any payment or reimbursement of GMTA taxes by a foreign affiliate. Such a rule would be analogous to the approach adopted in proposed subsection 18.2(10) and elsewhere in the ITA.

11. Elections

The GMTA contains several elections. In our view, the GMTA should be amended to allow such elections to be late filed (either as a right or with the consent of the CRA) – particularly during the fiscal periods in which the GMTA is first effective. Unlike the ITA, the GMTA does not currently provide a mechanism for late-filed elections.

12. Tax reform – simplification

Over the past decades, Canada's international tax regime has become exceedingly complex. We should be mindful of the recommendations made to the government in the past – including the 1997 Mintz Committee that highlighted the importance of economic efficiency, fairness and simplicity.

The proposed GMTA, and Pillar Two more generally, aims to create a consistent set of international tax rules that will apply to MNEs. However, in that context Canadian-based MNEs are at a significant disadvantage as a result of numerous out-dated and cumbersome "unilateral measures" that remain in the ITA. The introduction of the GMTA is an opportune time to revisit and remove or simplify many of those legacy tax measures to maintain the competitiveness of the Canadian tax system – and offset some of the material additional compliance costs stemming from the GMTA.

Examples of Canada's unilateral measures that should be simplified or removed include the following:

- **Canada's foreign affiliate surplus regime** – should be replaced with a "participation exemption" modeled after those in use by most other countries that are proceeding to enact an IIR under the GloBE model rules;
- **Canada's thin capitalization rules** – should be repealed, now that Canada has adopted EIFEL rules in a manner consistent with the earnings stripping rules recommended in the OECD BEPS project;
- **Canada's foreign affiliate dumping rules** – should be repealed, since those rules were introduced in lieu of interest restrictions in formerly proposed section 18.2 and are no longer necessary as a result of the EIFEL rules and other proposed amendments; and

- **Canada's FAPI rules** – could be significantly simplified with the introduction of the IIR in the GMTA.

13. Conclusion

Thank you for the opportunity to comment on the proposed GMTA. We trust that the Department of Finance will carefully consider and address the comments received during the public consultation process with a view to clarifying the GMTA and its integration with the ITA prior to the effective date. We would be pleased to discuss our comments at your convenience.

We consent to the public disclosure of this submission by the Department of Finance.

Yours very truly,

Osler, Hoskin & Harcourt LLP.

Osler, Hoskin & Harcourt LLP