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How the Multilateral Instrument May Impact the Taxation of Multinational Companies in Canada

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The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, also known as *the Multilateral Instrument* (the "**MLI**") is a multilateral treaty that was developed by the Organisation for Economic Co-operation and Development (the "**OECD**") as a part of its Base Erosion and Profit Shifting (BEPS) study.

The measures in the MLI are aimed at preventing multinational companies from misusing tax treaties to inappropriately shift profits in an effort to reduce their overall tax burden. Some of the MLI measures consist of minimum standards which must be implemented, and other measures are optional.

Over 70 jurisdictions around the world signed their intent to implement certain key measures (i.e. the minimum standards and possibly a few optional provisions) from the MLI into their respective bilateral tax treaties. The one notable exception from the signatories was the United States, which believes its tax treaties contain sufficient safeguards to prevent taxpayers from taking advantage of treaty-shopping. Once a jurisdiction deposits its instrument of ratification with the OECD, the MLI acts as a supplement that sits on top of a jurisdiction's bilateral tax treaty, with another jurisdiction that has also deposited its instrument of ratification with the OECD.

On August 29, 2019, Canada deposited its instrument of ratification with the OECD, which means that, at the time of writing, the MLI will modify its tax treaties currently with Australia, the United Kingdom, the Netherlands, Luxembourg, Israel, Ireland, India, Singapore, the United Arab Emirates and at least 14 other countries. These changes are effective January 1, 2020 in respect of withholding taxes and effective for taxation years beginning after May 31, 2020 for all other taxes. It will not impact Canada's tax treaties with Germany and Switzerland as new tax treaty negotiations with these countries have already begun or are expected to commence shortly. It is important to note that for an optional provision to apply to a specific bilateral tax treaty, both Canada and the participating jurisdiction must have agreed to apply that particular optional provision in their ratification process.

What are the Minimum Standards on Treaty Abuse that Canada has Committed to?

There are two minimum standards on treaty abuse that Canada has committed to. The first is an amendment to the preamble of its covered tax treaties to state that the bilateral tax treaty is intended to "eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements…)". The second is the introduction of a principal purpose test ("**PPT**"). The PPT is an overarching anti-avoidance rule that will deny a benefit under the treaty if it is reasonable to conclude that one of the principal purposes of the arrangement or transaction was to obtain the treaty benefit, unless it is established that granting the benefit would be consistent with the object and purpose of the provisions in the relevant bilateral tax treaty.

What are the Key Optional Measures that Canada has Chosen to Adopt?

<u>365-Day Test for Dividends</u>

A non-resident dividend recipient will now be required to hold the shares of the dividend payor for a minimum holding period of 365 days in order to qualify for the reduced treaty withholding rate.

<u>365-Day Test for Capital Gains</u>

A capital gain on shares of a corporation, a partnership interest or a trust interest, which derives its value from immovable property (i.e. real property), will be subject to tax in the jurisdiction where the real property resides, if at any time in the 365 days prior to the sale, no less than 50 per cent of the value of the property disposed of is derived from the value of the underlying real property.

<u>Dual Residency Rule</u>

In determining the tax residency of a dual resident taxpayer other than an individual (i.e.: a corporation), the competent authorities of both jurisdictions must strive to determine by mutual agreement the taxpayer's ultimate residency. In making the residency assessment, the competent authorities will consider the taxpayer's place of effective management, the place where it is incorporated, and any other relevant factors. When the competent authorities cannot come to a mutual agreement, the taxpayer will not be entitled to any relief or exemption under the particular tax treaty.

Additional Resources

With countries across the globe adopting different optional measures and depositing their instruments of ratification at different times, determining whether and when a specific optional measure under the MLI applies can be a difficult task. To assist, the OECD has created an **interactive database** which permits users to enter in different countries and specifics to determine whether an optional measure pairs.

Crowe Soberman's Tax Group is here to help taxpayers navigate their way through these new measures. Please contact Aaron Schechter or another member of our Tax Group for further assistance.

This article has been prepared for the general information of our clients. Specific professional advice should be obtained prior to the implementation of any suggestion contained in this article. Please note that this publication should not be considered a substitute for personalized tax advice related to your particular situation.

Connect with the Author

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With almost 20 years of experience in providing tax advice to privately owned and owner-managed clients, Aaron Schechter has demonstrated his dedication to ensuring his client's taxes are minimized and their capital is maximized. You can connect with Aaron at aaron.schechter@crowesoberman.com.

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