

CANADA RATIFIES THE MULTILATERAL INSTRUMENT

Posted on September 5, 2019

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On June 7, 2017, Canada along with [numerous other jurisdictions](#) signed the Organisation for Economic Co-operation and Development's ("OECD") *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the "MLI" or "**multilateral instrument**"). The multilateral instrument is the culmination of work undertaken as part of the [OECD/G20 BEPS Project](#) to equip governments with domestic and international instruments to address tax avoidance.

On June 21, 2019, Canada took an important step forward in the domestic ratification process required to bring the MLI into effect in Canada when Bill C-82, *An Act to implement a multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting*, received Royal Assent enacting the MLI into law in Canada.

The final step that would bring the MLI into force in Canada was completed on August 29, 2019 when Canada deposited its instrument of ratification with the OECD. The deposit of the instrument of ratification brings the MLI into force for Canada on December 1, 2019. The MLI will enter into effect for certain of Canada's tax treaties, including tax treaties with France and the United Kingdom, as early as January 1, 2020.

Background

The MLI consists of various countermeasures that were proposed as part of the OECD/G20 BEPS Project aimed at thwarting base erosion and profit shifting-type planning activities. However, rather than undertake the lengthy and tedious process of renegotiating existing bilateral tax conventions with each treaty partner jurisdiction, the MLI provides a framework and a mechanism to modify 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 in the MLI. At the time of signing the MLI, Canada had identified 75 tax treaties as Covered Tax Agreements, which has now been increased to 84 with the inclusion of nine additional treaties.

The overall effect of the MLI is to modify specific provisions of Covered Tax Agreements based on the standards introduced in the MLI. Subject to adopting the minimum standards set out in the MLI that all participating countries have agreed to adopt, signatories can opt in to one or more provisions of the MLI. Under the MLI, a

country may expand the scope of its commitment by withdrawing or limiting a reservation, but it cannot subsequently narrow its commitment by adding or broadening a reservation at a later date.

Commitments by Canada

Canada had originally taken a conservative approach and registered provisional reservations on all of the measures contained in the MLI except (i) the minimum standards on treaty abuse and dispute resolution, and (ii) the mandatory binding arbitration for disputes involving tax treaties.

Anti-Abuse Measures

The minimum standards to address treaty abuse, consisting of the preamble (Article 6) and a substantive anti-abuse rule (Article 7), will operate alongside Canada's Covered Tax Agreements. The preamble clarifies that the purpose of a bilateral tax treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. The anti-abuse rule consists of the "principal purpose test", which denies treaty benefits for an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in the benefit (unless the taxpayer establishes that granting the benefit in the circumstances would be consistent with the object and purpose of the relevant provisions of the treaty in question).

Dispute Resolution Measures

The minimum standards for resolving treaty-related disputes will also operate alongside Canada's Covered Tax Treaties once the MLI takes effect, requiring signatory jurisdictions to implement a mutual agreement procedure under which the competent authorities of each jurisdiction must attempt to resolve certain disputes within three years of notification of the dispute.

Finally, Canada has also opted into the mandatory arbitration procedures under the MLI, which are similar to the existing arbitration provisions under the *Canada-US Income Tax Convention*.^[1] The mandatory binding arbitration measures provide for two different arbitration mechanisms:

- The default mechanism, a "final offer" mechanism, where the competent authorities of two jurisdictions cannot come to an agreement within a specified period of time, under which each competent authority presents its own proposed resolutions and the arbitrators choose their preferred outcome between the two proposals that were submitted.
- An "independent opinion" mechanism, under which a decision is rendered by the arbitrators on the basis of their own analysis of the information provided to them.

Additional Commitments

Canada has expanded the scope of its initial commitment under the MLI by adopting the following additional optional provisions geared towards foreclosing perceived opportunities for taxpayers to avoid or reduce taxation in inappropriate circumstances:

- a. Deny the benefit of lower treaty-based withholding rate on dividends where non-resident companies hold shares of a Canadian company for less than 365-days (Article 8);
- b. Allow taxation by the source jurisdiction of capital gains derived by non-residents on interests that derive their value from Canadian immovable property where the relevant value threshold is met at any time during the 365 days preceding the alienation (Article 9); and
- c. Implement an approach to resolve dual resident entity cases, designed to prevent double taxation, as well as ensure that companies and other entities cannot avoid or reduce their taxes by strategically selecting their tax residence (Article 4).

Canada has also adopted a provision of the MLI that will allow certain treaty partners to move from an exemption system as their method of relieving double taxation to a foreign tax credit system (Article 5).

The Department of Finance has expressed its intention to adopt the detailed limitation on benefits provisions (composed of specific criteria) contained in the MLI over the longer term through the re-negotiation of its bilateral tax treaties (rather than through the MLI mechanism).

Next Steps

With the deposit of the instrument of ratification with the OECD, the MLI would enter into force in Canada on December 1, 2019.

Generally, the provisions of the MLI would then come into effect in Canada in respect of Covered Tax Agreements with countries that have completed their domestic procedures to cause the MLI to come into effect

- with respect to source withholding taxes paid or credited to non-residents, on January 1, 2020; and
- with respect to all other taxes, for taxable periods beginning after June 1, 2020.

Implications

The MLI will have far-reaching effects on the tax treatment of many cross-border arrangements. Canada's commitment under the MLI requires businesses to be forward thinking and anticipate transactions that may materialize in the near future to ensure compliance with the new requirements; otherwise, the MLI could operate to deny benefits under Canada's bilateral tax treaties, resulting in substantially higher tax burdens.

Now that the MLI has obtained Royal Assent, companies and individuals engaging in transactions with international tax implications should seek legal advice to ensure that their tax planning considers and addresses the new standards.

by Ehsan Wahidie and Michel Ranger

[1] The United States is not a signatory to the MLI.[ps2id id='1' target='']

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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