TaxNewsFlash Canada

Canada Signs on for BEPS Treaty Changes

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Now that Canada has signed the Multilateral Instrument, Canadian multinationals may be impacted by changes to tax treaties that could, in the future, affect their organization's global structure and operations. The Multilateral Instrument, which was developed as part of Action 15 of the Organization for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) initiative, will modify more than 2,000 tax treaties worldwide to implement certain BEPS measures without the need for bilateral negotiations.

The Multilateral Instrument was signed by Canada and more than 60 other countries at a ceremony held on June 7, 2017 in Paris, France. Countries signing onto the Multilateral Instrument include the UK, most European countries including Switzerland, Luxembourg and the Netherlands, and a number of Asian countries including China and Hong Kong. Following the ceremony, Finance announced that Canada will adopt the "mandatory binding arbitration" provision for dispute resolution and the "principal purpose test" (rather than a "limitations on benefits" provision) to address treaty abuse. Canadian multinationals should be aware of the provisions in the Multilateral Instrument that Canada has agreed to and review whether any of the treaty related BEPS measures may affect their organization in jurisdictions where they operate.

Background

Tax treaties are designed to eliminate double taxation that may occur for example, where multinationals engage in cross-border trade and investments. The sheer number of bilateral treaties makes updating the current tax treaty network highly burdensome.

The Multilateral Instrument, which began development in 2015, is intended to streamline the implementation of the tax treaty-related measures that have been developed in the course of the OECD's work on BEPS. Specifically, the Multilateral Instrument was developed to modify existing bilateral treaties to implement BEPS measures without the need to individually renegotiate each treaty. The Multilateral Instrument, which will co-exist with existing tax treaties rather than directly amending them, includes some flexibility so that each country may opt in or out of different provisions in certain circumstances (see *TaxNewsFlash-Canada* 2016-55, "Tax Treaties Poised to Include BEPS Measures").

Countries that have signed the OECD's Multilateral Instrument, including Canada, have agreed to accept the BEPS minimum standards relating to treaty abuse and dispute resolution:

- Treaty abuse (Action 6) — Countries must include in their tax treaties a clear statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, either through a "limitations on benefits" provision, a "principal purposes test", or a combined approach
- Dispute resolution (Action 14) — Countries must fully implement mutual agreement procedure (MAP) treaty obligations in good faith, including administrative processes that promote the prevention and timely resolution of treaty-related disputes and allow eligible taxpayers to access the MAP.

In the 2017 federal budget, Canada confirmed its intention to ensure that its tax system meets these minimum standards, and noted that it had already committed to improve efficiency and effectiveness of the mutual agreement procedures contained in its tax treaties.

Canada adopts principal purpose test

Canada has committed to the principal purpose test to address treaty abuse under Action 6 in accordance with the OECD's minimum standard. The principal purpose test is a general anti-abuse rule that considers whether one of the principal purposes of an arrangement or transaction is to obtain treaty benefits in a way that is not in accordance with the object and purpose of the relevant treaty provisions.

In addition, Finance announced that, over the longer term, Canada will seek to negotiate, on a bilateral basis, a detailed limitation of benefits provision that would also meet the minimum standard.

Canada accepts mandatory binding arbitration

Canada has also chosen to adopt the "mandatory binding arbitration" provision to improve dispute resolution. Finance notes that such a rule, which is intended to guarantee that treaty-related disputes are resolved within a specific time frame, is similar to the MAP article included in the Canada-U.S. tax treaty.

Affected treaties and agreements

At the signing ceremony, Canada provided the OECD with a provisional list of its treaties and agreements affected by the Multilateral Instrument, which include 75 treaties in total. Finance notes that the list of tax treaties includes “almost all” countries and jurisdictions that were members of the ad hoc group that developed the Multilateral Instrument, and that have a bilateral tax treaty with Canada. Specifically, this list notes affected treaties and agreements with the following countries:

- Argentina
- Australia
- Austria
- Azerbaijan
- Bangladesh
- Barbados
- Belgium
- Brazil
- Bulgaria
- Cameroon
- Chile
- China
- Colombia
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Dominican Republic
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Israel
- Italy
- Jamaica
- Japan
- Jordan
- Kazakhstan
- Kenya
- Korea
- Latvia
- Lithuania
- Luxembourg
- Malaysia
- Malta
- Norway
- Pakistan
- Philippines
- Poland
- Portugal
- Romania
- Russia
- Senegal
- Serbia
- Singapore
- Slovak Republic
- Slovenia
- South Africa
- Spain
- Sri Lanka
- Sweden
- Tanzania
- Thailand

- Egypt
- Estonia
- Finland
- France
- Gabon
- Greece
- Hong Kong
- Mexico
- Moldova
- Mongolia
- Morocco
- Netherlands
- New Zealand
- Nigeria
- Tunisia
- Turkey
- Ukraine
- United Kingdom
- Vietnam
- Zambia
- Zimbabwe

Finance also notes that, for a tax treaty to be modified, Canada's treaty partner must also ratify the Multilateral Instrument and list its tax treaty with Canada.

KPMG observations

Notably excluded from this list are Canada's treaties with the United States, Switzerland, and Germany. The United States previously indicated that it would not sign the Multilateral Instrument, as it already has robust limitation on benefits articles in almost all of its current treaties. Additionally, after the Multilateral Instrument was signed, Finance announced that Canada is entering into treaty negotiations with both Germany and Switzerland. Presumably, these direct bilateral negotiations will encompass many of the areas that would have been covered by the Multilateral Instrument, including the minimum standards noted above. It will be interesting to see whether the revised treaties will include a detailed limitation of benefits provision (similar to the Canada-U.S. Treaty) or a modified version of the principal purpose test along the lines of the provision contained in the Multilateral Instrument.

Next steps

At a recent tax conference, Finance noted that once Canada ratifies the Multilateral Instrument, it must provide the OECD with its final reservations and notifications (although Canada can still add countries to which the Multilateral Instrument will apply after ratification). Finance also said that, hypothetically, the coming-into-force date of the provisions in the Multilateral Instrument would probably not occur until January 1, 2019 at the earliest.

We can help

Your KPMG adviser can help you assess the potential impact of the Multilateral Instrument on your corporate structure and international tax planning. For more details on these developments and their potential effect, contact your KPMG adviser.

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