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E-BRIEF

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FISCAL AND TAX POLICY

High Stakes Ahead: Canada and the Global Minimum Tax for Multinationals

by
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- The 2022 federal budget launched consultations on the implementation of new proposed rules for a Global Minimum Tax of 15 percent, which was endorsed in principle by members of the OECD and G20 in 2021.
- In simple terms, the tax rules would apply to multinational enterprises (MNEs) with annual consolidated revenues generally of EUR 750 million. However, none of this is simple. The regime contemplates the introduction of a veritable tax smorgasbord, with countries grabbing for the taxes on a "first come, first served" basis.
- For Canadian multinationals, the strategic considerations will include identifying and implementing arrangements that serve to reduce effective tax rates in all locations to 15 percent. Canada could win or lose. If a multinational group has foreign earnings in a jurisdiction that imposes increased taxes, then taxes on those earnings will be paid in that jurisdiction, leaving nothing to be taxed by Canada. In contrast, if the group can shift those foreign earnings (either by shifting the location of related activities or otherwise) to a low-tax jurisdiction, or to Canada, then taxes on those earnings will be paid in Canada.
- Rather than raise additional revenues under the regime, Canada could suffer a net reduction in wealth and tax revenues. The reason: an increase in foreign taxes paid by Canadian-based multinationals would likely result in an offset against Canadian taxes otherwise payable by them; and, more importantly, result in a reduction in their after-tax foreign earnings.
- Canada will need to consider very carefully how to restructure and optimize various elements of its tax and fiscal policy in order to maximize the attractiveness of Canada for all MNE groups as a location for activities and investment. It should create a climate in which Canadian MNE groups have the incentive to maximize the repatriation of their foreign earnings.

The so-called Global Minimum Tax of 15 percent, or the "Pillar Two" regime, as contemplated in the "October Statement" of the Organisation for Economic Co-operation and Development

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(OECD)[1] – could have a material adverse effect on Canadian wealth, and Canadian tax revenues (Nikolakakis 2021).

If relevant foreign jurisdictions increase their tax rates accordingly (either in general or under Pillar Two), Canada's adoption of Pillar Two might not raise the $3.5 billion in annual tax revenues initially estimated by Canada's Finance Minister (Hall 2021).[2] In fact, Canada could suffer a net reduction in wealth and tax revenues. The reason: an increase in foreign taxes paid by Canadian-based MNEs would likely result in an offset against Canadian taxes otherwise payable by them;[3] and, more importantly, result in a reduction in the after-tax foreign earnings of our MNEs. This, in turn, would reduce their ability to reinvest, and reduce their distributions to Canadian stakeholders, with adverse implications for the overall Canadian economy.

Momentum has been building toward implementation of the minimum tax. The G20 leaders endorsed the October Statement, referring to it as a "historic achievement through which we will establish a more stable and fairer international tax system" (G20 Research Group 2021). Then, on December 20, 2021, the OECD released a package of Pillar Two model rules (the "Model Rules"), intended to "define the scope and set out the mechanism for the so-called Global Anti-Base Erosion (GloBE) rules under Pillar Two" (OECD 2021a,b).[4] On March 14, 2022, the OECD published a commentary on the Model Rules, as well as a set of Illustrative Examples (OECD 2022a,b), and announced a consultation on the Pillar Two Implementation Framework, which called for input to be submitted by April 11, 2022 (OECD 2022c). The 2022 federal budget launched consultations on the implementation in Canada of the Model Rules.

This E-Brief reviews the Model Rules, and their potential implications for Canada, in light of certain strategic and other considerations that may be relevant to how MNEs and various governments approach this initiative.

Overall Orientation

Despite the reference in the acronym GLoBE to "Anti-Base Erosion," it is important to understand that this regime is no longer focussed only on situations involving tax base erosion. The Model Rules would apply not only to cross-border income streams derived through low-tax entities, but also to value-creating business activities

1 See OECD/G20 (2021). The "October Statement" contemplates a "two pillar solution": Pillar One allocates new taxing rights to market countries for about 100 of the largest multinational enterprises (MNEs), and Pillar Two establishes a global minimum tax of 15 percent for MNEs with annual consolidated revenues of €750 million, which includes many Canadian MNEs.

2 Budget 2022, which launches a consultation on the implementation of Pillar Two, acknowledges that it is "not possible to reliably estimate the revenue impact at this time." See Tax Measures: Supplementary information, Table 1, note 4 (page 3).

3 Foreign taxes paid by Canadian-based MNEs (directly or through their subsidiaries) either in general or under Pillar Two would offset their Canadian Pillar Two liabilities. Such taxes may also offset normal Canadian corporate income taxes otherwise payable, although it remains unclear how Pillar Two would be integrated with existing corporate income tax and foreign tax credit rules. It seems reasonable to assume that mechanisms to eliminate double taxation would be introduced.

4 Unless otherwise defined herein, capitalized terms are taken from the Model Rules.

carried on within any jurisdiction, including Canada, subject to a modest Substance-Based Income Exclusion applying to a portion of payroll and tangible asset costs.[5]

Through a combination of mechanisms, the Model Rules would: (i) create implications and incentives or disincentives that would diminish – though not eliminate – the benefits for MNEs to derive cross-border income streams through low-tax entities; (ii) create incentives for certain governments to opportunistically raise their tax rates; and (iii) create disincentives for governments to rely on their tax systems as instruments of industrial and social policy, through the use of investment and development incentives.

The Mechanics of the Proposed Rules: Main Technical Elements

The Model Rules set out most of the main elements of Pillar Two, those being:

- an Income Inclusion Rule (or "IIR"), which consists of a main rule that would impose a so-called "Top-up Tax" on Ultimate Parent Entities, and certain other entities within an MNE Group,[6] to make up for any difference between the Minimum Rate of 15 percent and the effective tax rate already imposed on foreign earnings;[7]
- an Under-Taxed Payments/Profits Rule ("UTPR"), which consists of a back-stop rule that would allow subsidiary jurisdictions to impose a global Top-up Tax to the extent that parent jurisdictions failed to do so, and would even allow subsidiary jurisdictions to impose a tax at the Minimum Rate on the earnings of a parent company from activities in the parent jurisdiction;[8] and
- a Qualified Domestic Minimum Top-up Tax Rule ("QDMTT"), which consists of a rule that would allow all jurisdictions (that is, both parent jurisdictions and subsidiary jurisdictions) to impose a tax at the Minimum Rate on earnings from activities within their jurisdictions.

In addition to this, Pillar Two contemplates the possibility that jurisdictions could adopt a Subject to Tax Rule ("STTR"), in order to impose increased withholding taxes, capped at 9 percent (on a gross basis) rather than

5 The Substance-Based Income Exclusion would exclude from the global minimum tax profits up to 5 percent of payroll costs and 5 percent of tangible asset costs within each jurisdiction. Under transitional rules, this gearing would begin at 10 percent for payroll costs and 8 percent for tangible asset costs, both declining to 5 percent over a 10-year period.

6 The Model Rules contemplate the application of an IIR by Ultimate Parent Entities, as well as by Intermediate Parent Entities and Partially Owned Parent Entities. Priority goes to any Partially Owned Parent Entities, then to Ultimate Parent Entities, then to Intermediate Parent Entities.

7 The commentary to Model Rule 2.1.6 contemplates that an IIR (a "domestic IIR") could be applied by parent jurisdictions to domestic profits.

8 Under the Model Rules, the UTPR is not limited to payments made to Low-tax Entities by entities within a UTPR jurisdiction (and the acronym is no longer associated with the word "payments"). The allocation key for residual Top-up Tax liability among qualifying UTPR jurisdictions is based on their relative numbers of employees (not payroll costs) and tangible asset costs. It is this feature that could allow a subsidiary jurisdiction to impose a Top-up Tax on the profits earned in a separate subsidiary jurisdiction or in a parent jurisdiction. This is somewhat controversial. See Li (2022), Plunket (2022), and Nikolakakis (2022).

Box 1: At a Glance. Some Key Acronyms in this Study

GloBE : Global Anti-Base Erosion rules

Also referred to as the Pillar Two Model Rules, they are designed to ensure large multinational enterprises (MNEs) pay a minimum level of tax of 15 percent on a net basis on the income arising in each jurisdiction where they operate.

IIR: Income Inclusion Rule

Under the IIR, the minimum tax is paid at the level of the parent entity, in proportion to its ownership interests in those entities that have low-taxed income.

QDMTT: Qualified Domestic Minimum Top-up Tax Rule, or Domestic Top-up Rule

Allows low-tax countries to apply a top-up tax on low-taxed entities within their borders without having to increase their low-tax rates – even no-tax jurisdictions can impose the top-up tax.

UTPR: Under-Taxed Payments/Profits Rule, or Global Backstop

The Undertaxed Payments/Profits rule (UTPR) has the same general purpose as the income inclusion rule (IIR). More specifically, the policy rationale of the UTPR is to serve as a backstop to the IIR, in the sense of allowing subsidiary jurisdictions to impose the Top-up Tax to the extent that parent jurisdictions fail to impose it under an IIR.

STTRs: Subject to Tax Rules

The STTR will be triggered where a covered payment is subject to a nominal tax rate in the payee jurisdiction that is below an agreed minimum rate of 9 percent on a gross basis.

Sources: OECD at: https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf

OECD Library at: https://www.oecd-ilibrary.org/sites/c65c7c20-en/index.html?itemId=/content/component/c65c7c20-en#:~:text=Subject%20to%20Tax%20Rule%20applies,changes%20in%20the%20tax%20base

CrossBorder Solutions at: https://crossborder.ai/article/could-pillar-two-mean-double-taxation-for-mnes/

the 15 percent rate (on a net basis) applicable under the Model Rules, on certain payments to low tax entities, such as interest and royalty payments.[9]

Jurisdictions would also be free to apply income attribution rules, such as Canada's "foreign accrual property income" ("FAPI") rules ("Controlled Foreign Company" / "CFC Rules"), and to treat foreign entities as being fiscally transparent ("Hybrid Rules"), and thereby tax their income in the hands of their equity holders.

In terms of relative priorities, the Model Rules contemplate that STTRs and QDMTTs (as well as normal local income taxes) would take precedence over the IIR and the UTPR, and the IIR would take precedence over the UTPR. Thus, a parent jurisdiction seeking to impose an IIR would be required to offset any foreign tax imposed under a STTR or a QDMTT. Likewise, a jurisdiction imposing tax under a UTPR would be required to offset any tax imposed by another jurisdiction under a STTR or a QDMTT or an IIR. What remains a bit uncertain at this stage is whether taxes imposed by a parent jurisdiction under CFC Rules or Hybrid Rules would take precedence over the QDMTT, although it seems clear that they would take precedence over the IIR and the QDMTT.[10]

The Model Rules contemplate the following process for determining the required Top-up Tax:

1. MNE Groups would first determine the jurisdictional location of all their Constituent Entities ("CEs" or "entities"), which would include all entities and permanent establishments, as defined.[11]
2. MNE Groups would then compute their Excess Profits for each relevant jurisdiction (i.e., each separate jurisdiction where a parent has entities), based on the net GLoBE Income of all entities located in that jurisdiction. An important distinction to consider is that GLoBE Income is to be determined using entities' financial accounting principles (adjusted in accordance to Model Rules) as opposed to domestic tax rules. Excess Profits for each jurisdiction would exclude a Substance-Based Income Exclusion, which after a 10-year transition period would be determined as 5 percent of eligible payroll and 5 percent of eligible tangible asset costs within that jurisdiction.[12]
3. MNE Groups would then compute, for each relevant jurisdiction, the aggregate Adjusted Covered Taxes allocated to that jurisdiction (essentially, any income taxes, including under STTRs, already imposed or accrued separately from the Model Rules), based on financial accounting tax expense (including both the current tax provision and certain items of the deferred tax provision), adjusted in accordance with the Model Rules.
4. MNE Groups would then determine the effective tax rates for each jurisdiction (essentially, the aggregated Adjusted Covered Taxes over the aggregated Net GLoBE Income for each jurisdiction) which, compared to the Minimum Rate, would yield the jurisdiction's Top-up Tax Percentage.

9 This measure is intended to allow developing countries to collect a greater share of taxes. Where the rate of withholding tax is limited by an income tax convention, this would require an amendment to that convention.

10 This is clear for IIRs and UTPRs under Model Rules 4.3.2(c) and (d), subject to a cap under Model Rule 4.3.3 of 15 percent (less any normal local taxes) for Passive Income, which makes sense because CFC Rules and Hybrid Rules are consistent with the "top-down" approach to rule priorities that applies to IIRs and UTPRs, but they are not consistent with the "bottom-up" approach that applies to QDMTTs, so Model Rules 4.3.2(c) and (d) may ultimately prove to be politically unpalatable in the latter context.

11 Permanent establishments would constitute CEs that are separate from the Entities to which they belong.

12 The transitional rules contemplate an initial rate of 10 percent of payroll costs and 8 percent of tangible asset costs, declining annually until the 5 percent rate is reached.

5. Finally, the Top-up Tax Percentage for each jurisdiction would be applied to the Excess Profits of that jurisdiction, then any QDMTT for that jurisdiction would be deducted, yielding the ultimate amount of the Top-up Tax liability for that jurisdiction. The aggregate amount of Top-up Tax liability for each jurisdiction where a parent has entities would then have to be imposed by the UPE jurisdiction (or another parent jurisdiction) under an IIR, failing which it could be imposed by a subsidiary jurisdiction (or a parent jurisdiction) under a UTPR.[13]

However complex this process may seem, the reader should bear in mind that the above description is a bare-bones simplification of it.

It is also important to emphasize that, under the Model Rules, a significant change has been made to the UTPR. Under previous descriptions, this mechanism would serve in part as a back-stop to the IIR mechanism, but it would only apply to the extent that deductible payments are made to low-tax entities. This is no longer the case under the Model Rules. The UTPR continues to serve as a back-stop to the IIR, but now it would apply regardless of whether or not deductible payments are made to low-tax entities. Thus, the UTPR would allow a subsidiary jurisdiction to impose Top-up Tax on earnings that have no connection to activities within that jurisdiction (e.g., to profits from value-creating activities in another subsidiary jurisdiction or in a parent jurisdiction). Thus, for example, if the Excess Profits of a Canadian MNE from activities in Canada have an effective tax rate below 15 percent, and Canada has not opted to impose a QDMTT (or has not yet done so), then any jurisdiction in which the MNE group may have operations can impose a Top-up Tax on the Canadian Excess Profits, under a UTPR.[14]

Strategic Considerations for MNEs

For MNE groups, the strategic considerations would include identifying and implementing arrangements that serve to reduce the effective tax rate in all locations to 15 percent. These may also include considerations relating to selecting the jurisdictions to which there may be a preference to pay their taxes, for a variety of reasons. For example, if a Canadian-based MNE has foreign earnings in a jurisdiction that imposes a QDMTT, then taxes on those earnings will be paid in that jurisdiction, leaving nothing to be taxed by Canada, even if Canada adopts an IIR. In contrast, if the MNE group can shift those foreign earnings (either by shifting the location of related activities or otherwise) to a low-tax jurisdiction that does not have a QDMTT, then taxes on those earnings will be paid in Canada, assuming Canada adopts an IIR. Depending on a variety of considerations, be they strategic or patriotic, Canadian-based MNE groups may prefer to pay the taxes on their foreign earnings either to foreign jurisdictions or to Canada.

Strategic Considerations for Low-Tax Jurisdictions

For low-tax jurisdictions, an important consideration would be whether or not to adopt a QDMTT. If the relevant income will in any event be taxed under an IIR, these jurisdictions may feel that they have nothing to lose and

13 Under the Model Rules, a parent jurisdiction could also technically be a UTPR jurisdiction. It can also impose a QDMTT, or a domestic IIR.

14 As noted, a parent jurisdiction could also technically be a UTPR jurisdiction. Thus, if a parent jurisdiction has not adopted a QDMTT or a domestic IIR but it has adopted a UTPR, it would share in the residual Top-up Tax liability with all other UTPR jurisdictions.

only tax revenues to gain, opportunistically, from the adoption of a QDMTT. However, on the other hand, since a QDMTT takes priority over an IIR, it may also be rational for (some of) these jurisdictions to decline to impose a QDMTT, either in general or at least in certain cases, in order to attract activities and income from MNE Groups that would prefer, for strategic or other reasons, to pay their Top-up Taxes to their parent jurisdictions. Increasing normal tax rates is also an option, but perhaps not preferable to adopting a QDMTT, because that tax would apply only to large MNEs, and would include a Substance-Based Income Exclusion, allowing the continued use of incentives within that threshold.

Strategic Considerations for Canada

For relatively high-tax jurisdictions such as Canada, the adoption or not of a QDMTT also gives rise to strategic and other considerations. Since the Model Rules are not limited to cross-border income flowing through low-tax jurisdictions, it would in general be rational for jurisdictions like Canada to adopt a QDMTT, in order to tax income that would in any event be subjected to an IIR (or a UTPR) in another jurisdiction, thereby diminishing treasury transfer effects.[15] However, it is important to emphasize that a QDMTT, or an IIR or a UTPR imposed by another jurisdiction, would restrict our ability to deploy tax incentives as levers at the service of industrial and development policy.

We will also have to consider how to restructure our incentive programs in ways that are optimal in light of the Model Rules. For example, under the Model Rules, so-called Qualified Refundable Tax Credits are accounted for as additional earnings and thus do not reduce tax expense, whereas other credits are accounted for as reductions to tax expense. The difference is important, because items that resemble government grants and are therefore accounted for as additional earnings may result in Top-up Tax liability equal to 15 percent of such additional earnings, whereas items accounted for as reductions in tax expense may result in Top-up Tax liability equal to 100 percent of such reductions.[16]

The treatment under the Model Rules of costs such as resource royalties (and similar impositions) is also something to consider – in that some of these could be accounted for as reductions in earnings rather than as tax expense.[17] This puts upward pressure on the computation of Top-up Tax, in that reductions in earnings would reduce Top-up Tax liability equal to 15 percent of such earnings reductions, whereas items treated as tax expense would reduce Top-up Tax liability dollar-for-dollar.

Simply put, Canada will want its incentive tax benefits to be accounted for as earnings (or not even as earnings at all, if possible) rather than as reductions in tax expense, and will want its royalties and other such impositions to be accounted for as tax expense rather than as reductions in earnings.

15 And subject to the possibility that foreign parent CFC Rules could take precedence over a Canadian QDMTT. If that is the case, a Canadian QDMTT would not prevent a treasury transfer by virtue of a foreign parent's CFC Rules, even though it would prevent the application of foreign IIRs and UTPRs.

16 The term Qualified Refundable Tax Credit is defined as "a refundable tax credit designed in a way such that it must be paid as cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit under the laws of the jurisdiction granting the credit", which would not cover many existing Canadian SR&ED credits or investment tax credits.

17 See the discussion in the commentary to Model Rule 4.2.1.

In a sense, Canada has already had to consider these types of questions, because of our exposure to the US Global Intangible Low-Taxed Income ("GILTI") regime, which can affect incentives to Canadian operations of US MNE groups. GILTI is somewhat of a hybrid between a minimum tax and a CFC Rule. It provides for US taxation of the foreign earnings of US MNE groups (computed under US tax principles rather than financial accounting principles), at about half the normal US tax rate (and subject to a limited credit for any qualifying foreign taxes). The substance-based income exclusion under GILTI only takes into account a percentage of tangible asset costs (and not any payroll costs), and is computed on a world-wide basis rather than on a jurisdiction-by-jurisdiction basis. However, because of Canada's disproportionate exposure to the US economy relative to other countries, the exercise becomes more complicated, to the extent that our approach will have to strive toward optimality in light of both the Model Rules and the US GILTI regime, which may or may not be modified to become consistent in certain contexts over the years.[18]

In addition, while the US GILTI regime mainly affects only Canadian operations of US MNE groups, which parallels, although not exactly, the impact of the IIR on the Canadian operations of other MNE groups, the UTPR is much broader in that it can affect the Canadian operations of Canadian MNE groups, since it allows subsidiary jurisdictions to tax the Canadian earnings of Canadian MNE groups, as noted above in relation to the structure of our incentive programs and other features of how we tax Canadian operations.

Another important consideration for relatively high-tax jurisdictions such as Canada is whether or not, and how, to restructure their international tax systems in order increase the probability that their MNE groups would pay the Top-up Tax to those jurisdictions rather than to foreign jurisdictions. For example, since the spread between the Minimum Rate and the Canadian rate on foreign earnings remains considerable at more than 10 percent, MNE groups would continue to have the incentive to localize such earnings in foreign jurisdictions, with a view to paying no more than the Minimum Rate. It is difficult to imagine that MNE groups would consider it consistent with their competitiveness imperatives to collapse their foreign tax arrangements and start paying taxes on such earnings in Canada, unless Canada were to reduce the Canadian rate on foreign earnings to (or to a rate that is much closer to) the Minimum Rate.[19] If Canada were to do so, then it would be reasonable to expect a significant increase in Canadian tax revenues, and a reduction in the leakage of Canadian wealth in the form of paying foreign taxes. If Canada does not do so,[20] it would be reasonable to expect a net reduction in Canadian

18 GILTI would have been modified in certain respects (to apply on a jurisdiction-by-jurisdiction basis, to make it align better with the Pillar Two regime) under the US *Build Back Better* bill, but that bill so far has failed to make it through the US Congress. It should also be noted that the Biden administration has proposed (in its March 28, 2022 "Greenbook") further modifications to US tax rules to implement Pillar Two, such as an increase to the rate for GILTI, the adoption of a QDMTT and a UTPR, and the repeal of the existing Base Erosion and Anti-Abuse Tax ("BEAT"), among other changes.

19 An analogy that comes to mind in this context is the US Foreign-Derived Intangible Income ("FDII") regime, which reduces the US rate on certain direct foreign earnings (as opposed to the foreign earnings of CFCs), as a companion to the US GILTI regime.

20 While uncertain, it may also be possible to address this concern to some extent by introducing an alternative defensive measure – perhaps such as a special set of CFC Rules, which would impose tax at the Minimum Rate, and be designed to take precedence over foreign QDMTTs. However, such a measure might only be effective as against foreign QDMTTs, and not as against "normal" foreign taxes. For example, Ireland imposes a "normal" tax at the rate of 12.5 percent, and may adopt a QDMTT. In that context, even if effective, a special set of Canadian CFC Rules would only take precedence over the additional 2.5 percent of taxes imposed under an Irish QDMTT, and not over the "normal" Irish tax of 12.5 percent. To get at that 12.5 percent of wealth leakage, Canada would have to eliminate or substantially reduce the incentive of MNE groups to locate foreign earnings in Ireland.

wealth and tax revenues because of an increase in foreign tax liabilities and a consequential reduction in the repatriation and distribution of foreign earnings by Canadian-based MNEs.[21]

Table 1 compares four illustrative scenarios involving a Canadian-based MNE with operations in a high-tax foreign country, using as an intermediary a traditional no-tax group financing company or intellectual property ("IP") company. For simplicity, the Canadian-based MNE is owned by a Canadian pension fund exempt from taxes on the dividend distributions it receives. The current regime is compared to the Pillar Two regime and a "Canada First" regime in which Canada reduces its rate on foreign earnings to the Minimum Rate of 15 percent so that the Canadian-based MNE group organizes its affairs to pay tax at the Minimum Rate in Canada.

The differences between the various scenarios are material. If Canada simply adopts Pillar Two without making other strategic adjustments, we will likely be impoverished. The best outcomes would arise if Canada were to adopt a Canada First approach, whereby Canadian MNE groups had the incentive to reduce foreign taxes, in a way that results in Canada being the country that collects the 15 percent Global Minimum Tax. This may take some political finesse, but the policy considerations are pretty clear.

Table 1: Resulting Canadian Wealth and Tax Under Various Illustrative Scenarios, $

	Illustrative Scenarios			
	Current Regime	Pillar Two	No Planning	Canada First
Interest/Royalty paid by subsidiary in high-tax jurisdiction (Foreign Opco)	100	100	0	100
Foreign tax savings in Opco Jurisdiction (25%)	25	25	0	25
Tax in foreign financing/IP company (Finco/IPco) jurisdiction (with QDMTT)	0	15	N/A	N/A
Distribution/Payments to Canadian parent company (Canco)	100	85	75	100
Tax in Canada (under Pillar Two, or similar)	N/A	0	0	15
Tax in Canada on distributions to Canco	0	0	0	N/A
Distribution by Canco to Canadian Pension Fund	100	85	75	85
Tax on paid out pension benefits (at 30%)	30	25.5	22.5	25.5
Consumption tax (15%)	10.5	8.9	7.9	8.9
Canadian wealth	100	85	75	100
Canadian tax	40.5	34.4	30.4	49.4

21 Reduced repatriations and distributions would also tend to reduce Canadian personal income taxes, and even Canadian sales and value-added taxes. This can become a very complicated modeling and impact assessment exercise.

Table 1: Continued

Illustrative Scenario Descriptions

Current Regime: The Canadian subsidiary (Foreign Opco) makes a $100 deductible interest/royalty payment to a foreign financing/IP company (Finco/IPco), saving $25 in tax in the high-tax jurisdiction and incurring no tax in the Finco/IPco jurisdiction. $100 is distributed to the Canadian parent company (Canco) on which no tax is incurred in Canada due to our foreign affiliate rules. The $100 is distributed to the Canadian pension fund owner, and $30 in personal income tax is paid by pension benefit recipients, with an additional $10.50 in consumption tax on purchases. Pre-tax Canadian wealth is $100, and Canadian tax collected is $40.50.

Pillar Two: Foreign Opco makes a $100 deductible interest/royalty payment to Finco/IPco, saving $25 in tax in the high-tax jurisdiction and incurring $15 under a QDMTT in the Finco/IPco jurisdiction. $85 is distributed to Canco on which no tax is incurred in Canada. $85 is distributed to the Canadian pension fund owner, and $25.50 in personal income tax is paid by pension benefit recipients, with an additional $8.90 in consumption tax on purchases. Pre-tax Canadian wealth is $85, and Canadian tax collected is $34.40. Canada has lost $15 of wealth, and some tax revenues.

No Planning: Foreign Opco makes a $75 distribution to Canco, from $100 of income on which $25 of tax is paid to the foreign jurisdiction. $75 is distributed to Canco on which no tax is incurred in Canada. $75 is distributed to the Canadian pension fund owner, and $22.50 in personal income tax is paid by pension benefit recipients, with an additional $7.90 in consumption tax on purchases. Pre-tax Canadian wealth is $75, and Canadian tax collected is $30.40. Canada has lost $25 of wealth, and even more tax revenues.

Canada First: Canada reduces its rate on foreign earnings to the Minimum Rate of 15 percent. The Canadian-based MNE group organizes its affairs to pay tax at the Minimum Rate in Canada. Foreign Opco makes a $100 deductible interest/royalty payment to Canco, saving $25 in tax in the high-tax jurisdiction. Canco pays $15 of tax to Canada. $85 is distributed to the Canadian pension fund owner, and $25.50 in personal income tax is paid by pension benefit recipients, with an additional $8.90 in consumption tax on purchases. Pre-tax Canadian wealth is $100, and Canadian tax collected is $49.40. Canada has lost no wealth, and collected more taxes than in all other scenarios.

Incidence: It is also possible that some increased corporate income taxation may translate into lower wages or higher consumer prices, or lower reinvestment, rather than lower dividends. Lower foreign wages or higher foreign consumer prices could compensate Canada for higher foreign taxes, but lower Canadian wages or higher Canadian consumer prices would not compensate Canada for higher foreign taxes. Lower reinvestment could affect the productivity and competitiveness of Canadian-based MNEs.

Conclusion

In brief, the Pillar Two regime contemplates the introduction of a veritable fiscal smorgasbord, with countries grabbing for the taxes on a "first come, first served" basis. MNE groups will strive toward achieving an effective tax rate in every jurisdiction of no more than 15 percent. Canada will need to consider very carefully how to restructure and optimize various elements of our tax and fiscal policy in order to maximize the attractiveness of Canada for all MNE groups as a location for activities and investment, as well as to create a climate in which Canadian MNE groups have the incentive to maximize the repatriation of their foreign earnings.

This initiative will continue to develop in the coming months and years as countries work through the Implementation Framework. Things to watch for will include: (i) the basic progress and evolution of this initiative (or lack thereof – as there are already some signs it may be delayed); (ii) the possibility of the US GILTI regime (among others, including the US FDII and BEAT regimes) being modified and/or being declared to be compatible or incompatible with the Pillar Two regime; and (iii) how various other countries may revisit and adapt their tax and fiscal policy choices in order to maximize their respective strategic interests.

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