Intelligence MEMOS

From: Angelo Nikolakakis

To: Finance Minister Chrystia Freeland

Date: July 13, 2022

Re: **Global Tax Deal: Who Wins and Who Loses?**

The 2022 federal budget launched consultations on the implementation of 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 "Pillar Two" tax rules would apply to multinational enterprises (MNEs) with annual consolidated revenues generally of €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: a likely increase in foreign taxes paid by Canadian-based multinationals would result in a reduction in their after-tax foreign earnings.

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. In fact, Canada could suffer a net reduction in wealth and tax revenues. The increase in foreign taxes paid by Canadian-based MNEs would likely result in an offset against otherwise payable Canadian taxes; and, more importantly, result in a reduction in after-tax foreign earnings. This, in turn, would reduce their ability to reinvest, and reduce their distributions to Canadian stakeholders, with adverse implications for the overall Canadian economy.

Canada will need to consider very carefully how to restructure and optimize various elements of its tax and fiscal policy in order to maximize our attractiveness for all MNE groups as a location for activities and investment.

One 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 any Pillar Two tax at home. Currently the gap between the Pillar Two minimum rate and the Canadian rate on foreign earnings remains considerable at more than 10 percent. Thus, MNE groups would continue to have the incentive to localize such earnings in foreign jurisdictions.

And that is unlikely to change unless Canada were to reduce its rate on foreign earnings to (or much closer to) the 15-percent minimum rate. 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, it is only reasonable to expect a net reduction in Canadian wealth and tax receipts.

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