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# Tax Alert – Canada

## Canada signs the MLI: some further observations

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 7 June 2017, Canada and 67 other countries became signatories and parties to the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI). A further eight countries expressed their intent to sign the convention. The United States has notably, and not unexpectedly, not signed the MLI and has not expressed an intention to do so. The UK and all the other members of the G7 (other than the US) have signed the MLI, as well as all of the members of the G20 (other than Brazil, Saudi Arabia and the US).

### Background

The MLI seeks to amend bilateral tax treaties through an expedited and aggregated process, thereby reducing the need for individual states to enter into bilateral negotiations, which can take many years. Before the proposed treaty amendments become law, they will need to be ratified by each contracting state of a particular treaty. The earliest time they are generally expected to enter into effect is 2019.

Canada currently has 93 comprehensive tax treaties in force and is seeking to amend 75 of those under the MLI. Of the 18 treaty partners in respect of which Canada has not sought to amend the MLI, fourteen are not themselves signatories to the MLI (Algeria, Ecuador, Guyana, Ivory Coast, Kyrgyzstan, Oman, Papua New Guinea, Peru, Taiwan, Trinidad and Tobago, the UAE, the US, Uzbekistan, Venezuela). The remaining four consist of Kuwait, Armenia, Germany and Switzerland. The Canada-Germany and Canada-Switzerland treaties are, however, under negotiation, and Switzerland has expressly stated that it intends to meet the minimum standards either by way of the MLI or by way of bilateral negotiations.

## Implications

The MLI contains certain minimum standards that must be accepted by the signatories and a host of optional standards that can be accepted by the signatories, should they so desire. The minimum standards include a revised preamble for the convention as a whole (Article 6), as well as a broad-based principal purpose test (PPT), coupled with an optional simplified limitation on benefits test, or a detailed limitation on benefits test (Article 7), designed to prevent the use of treaties to reduce or eliminate tax altogether and treaty shopping, respectively. Canada has signed up to accept these minimum standards, and in so doing has stated that it intends to adopt the PPT as an interim measure with a view to entering into bilateral negotiations to adopt a limitation on benefits provision in addition to, or in replacement of, the PPT. If two signatories have not elected the same minimum standards under Article 7, the minimum standard defaults to the PPT, subject to some exceptions.

Article 6(1) of the MLI introduces the following wording, as a minimum standard, into the preamble of Canada's tax conventions; "Intending to eliminate double taxation with respect to taxes covered by this agreement without creating opportunities for non-taxation or reduced-taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of third jurisdictions)".

The PPT amendment under Article 7(1) of the MLI introduces the following wording into Canada's tax conventions; "... a benefit ... shall not be granted in respect of 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 that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purposes of the relevant provisions of the ... Agreement". It should be noted that Canada has not chosen to apply Article 7(4), which allows for discretionary and possibly derivative benefits to be granted.

Article 6 is generally aimed at curtailing structures that eliminate or reduce tax rather than simply eliminating double tax and could conceivably increase the likelihood of Canada's general anti-avoidance rule being applied to deny benefits that might otherwise be available under certain treaties. Article 7 introduces significant uncertainty as to whether a resident of a contracting state is entitled to benefits under a treaty, which could conceivably be one of the principal reasons behind Canada's intention to enter into detailed limitation on benefits provisions, which are generally seen to be more objective and which therefore provide greater certainty for taxpayers.

Canada has elected for now not to adopt any of the optional provisions encompassing the following broad topics: Transparent Entities, Dual Resident Entities, Application of Methods of Elimination of Double Tax, Dividend Transfer Transactions, Capital Gains from the Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property, Anti-Abuse Rule for Permanent Establishments in Third Jurisdictions, Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents, Artificial Avoidance of Permanent Establishment Status Through Commissionnaire Arrangements and Similar Strategies, Artificial Avoidance of Permanent Establishment Status through Specific Activity Exemptions, Splitting up of Contracts, and the Definition of a Person Closely Related to an Enterprise.

Canada has elected to apply Mandatory Binding Arbitration with certain specific reservations, and has made specific reservations with regards to Mutual Agreement Procedures and Compatibility. See EY's [Tax Alert No. 25](#) for more information.

Given the multitude of domestic provisions that Canada has enacted over the last few years, it's not entirely surprising that Canada has for now generally opted out of most of the standards that are not minimum standards.

## Learn more

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