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2023 CANADA FORUM

Global tax challenges for Canadian businesses in 2024

October 18, 2023

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Your speakers

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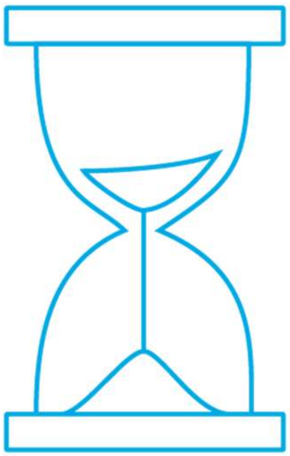
Agenda



- Canadian payroll and individual income tax implications of globally mobile employees
- EIFEL
  - Application
  - Implications
  - Considerations
  - Next Steps
- International Tax Updates
  - Updates to Sections 15 and 90 – cross-border financing transactions
  - Updates to the withholding tax regime
- OECD two-pillar solution updates

Learning objectives

By the end of this presentation, participants will be able to:

1. Explain Canadian payroll and tax obligations for foreign employees in Canada
2. Describe the overview of EIFEL rules including its application, computation, implications, and next steps
3. Determine the implications of Pillar One and Two on Canadian taxpayers
4. Understand international tax updates introduced in Bill C-47 and their implications

Canadian payroll and tax obligations for foreign employees in Canada

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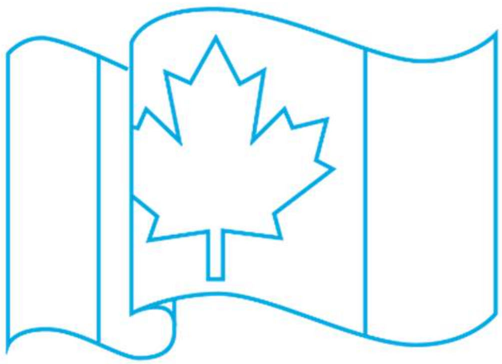
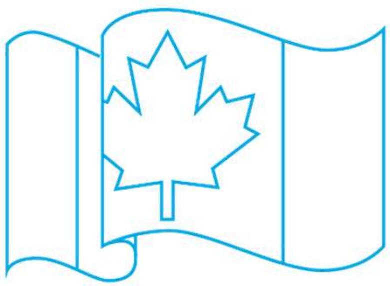
Canadian payroll and tax obligations for foreign employees in Canada

- Canadian Payroll
  - Source Deductions
    - Income Tax
    - Canada Pension Plan (CPP)
    - Employment Insurance (EI)
  - Provincial Payroll Costs
    - Provincial health tax
    - Worker's compensation, etc.)
  - Annual Filings
    - T4

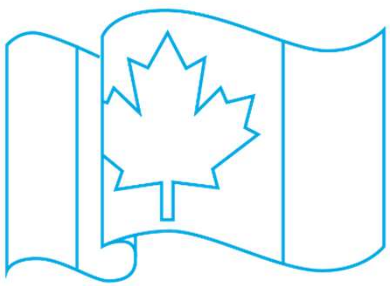


Canadian payroll and tax obligations for foreign employees in Canada



- Canadian Payroll (con't)
  - Tax Treaty Exemption – can be used for payroll requirements
  - Form RC473
    - Less than 45 days in the calendar year; or
    - less than 90 days in any 12-month period
    - T4 form is still required – unless < C$10,000
  - Regulation 102 Waiver
    - If RC473 is not applicable but they are still exempt under Treaty
      - Less than 183 days in 12-month period
      - No Permanent establishment in Canada
    - T4 form still required

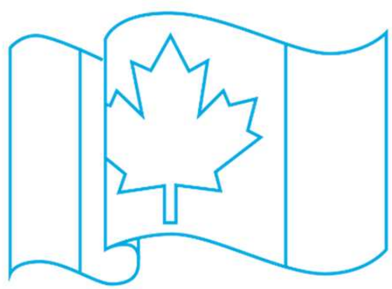
Canadian payroll and tax obligations for foreign employees in Canada



- Canadian Payroll (con't)
  - Social Security Exemptions
    - Canada Pension Plan (CPP)
      - Physically working in Canada < five years
      - Exempt from CPP – Employee and Employer
      - Certificate of Coverage
    - Employment Insurance (EI)
      - Exempt if subject to unemployment insurance in the foreign country
      - There is no certificate required

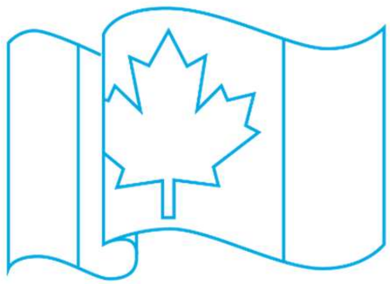
Canadian payroll and tax obligations for foreign employees in Canada

- Canadian individual tax
  - Canadian individual taxation on Canadian source employment income
  - Canadian individual income tax return:
    - Pay Canadian tax
    - Claim Treaty Exemption
  - Form RC473
    - T4 not required if earned less than C$10,000
    - Canadian individual tax return is not required



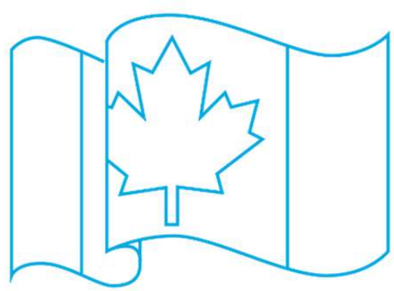
Canadian payroll and tax obligations for foreign employees in Canada

- Canadian Income Tax and Immigration
  - Canadian payroll account number
  - Canadian Social Insurance Number (SIN)
  - Canadian work permit
  - Canadian corporate tax issues for the employer
  - Canadian sales tax issues for the employer



Canadian payroll and tax obligations for foreign employees in Canada

- What to watch out for
  - Foreign entities sending employees into Canada
  - Canadian entities sending employees to foreign countries
  - Cross-border mergers and acquisitions
  - Individuals moving into or out of Canada
  - International payments



Excessive interest and financing expense limitation (EIFEL) rules

Overview

What

Limit a corporation's net interest and financing expenses (IFE) to a fixed ratio of tax EBITDA

How

Interest deduction in excess of the deduction capacity is denied

When

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Tax years beginning on or after October 1, 2023 (as proposed)

Application

- EIFEL will only apply to corporations and trusts that are not "excluded entities"
- Excluded entities
  - Canadian-controlled private corporations ("CCPCs") (along with associated corporations) who have taxable capital of less than $50,000,000
  - Taxpayers (along with group members) who have net IFE (IFE less IFR) in Canada less than $1,000,000
  - Taxpayers (along with group members) who carry on all or substantially all their business in Canada, throughout the particular year, and do not have:
    - a foreign shareholder owning 25% (or more) of the particular entity's votes or value;
    - a "material" foreign affiliate that can be valued at more than $5,000,000; or,
    - all or substantially all of their IFE is payable to persons who are not non-arm's length

Computation

- Step 1: Compute interest and financing revenues (IFR)
- Step 2: Compute deduction capacity
  - "Deduction capacity" is made up of IFR, 30% or 40% of tax EBITDA, absorbed capacity, and received capacity
  - Absorbed and received capacity: Excess capacity either from previous periods or transferred from a group member (on joint election)
- Step 3: Compare IFE to deduction capacity

IF: Deduction capacity > IFE = carry forward
IF: Deduction capacity < IFE = denied IFE

Computation – example

Assume a corporation has the following income items for the 2025 tax year:

- Tax EBITDA = $8,000,000
- Interest revenues = $200,000
- Interest expenses = $3,000,000

Applying the steps:

- Step 1: Compute interest and financing revenues (IFR): $200,000
- Step 2: Compute deduction capacity:

  = Fixed ratio x tax EBITDA + IFR = 30% x $8,000,000 + $200,000 = 2,600,000
- Step 3: Compare IFE to deduction capacity: $3,000,000 > $2,600,000

Since IFE is greater than deduction capacity → $400,000 denied IFE

Computation – group ratio

- The "group ratio" is an alternative to using the fixed ratio (40% of tax-EBITDA for Oct. 2023 to Dec., and 30% for 2024 onward)
- This could produce deduction capacity greater than the 30% or 40% of tax-EBDITA
- Deduction capacity can be allocated in a flexible manner between Canadian group members
- Requires audited financial statements

$$\text{Group Ratio} = \frac{\text{A: the consolidated group's net interest expense}}{\text{B: the consolidated group's EBITDA}}$$

Implications

- Increased cost of borrowing in an inflationary economy may result in higher IFE among Canadian taxpayers
    - Concerned industries may include real estate and private equity
- Watch out for EIFEL’s impact on cash flow, if certain entities are highly leveraged with third-party debt

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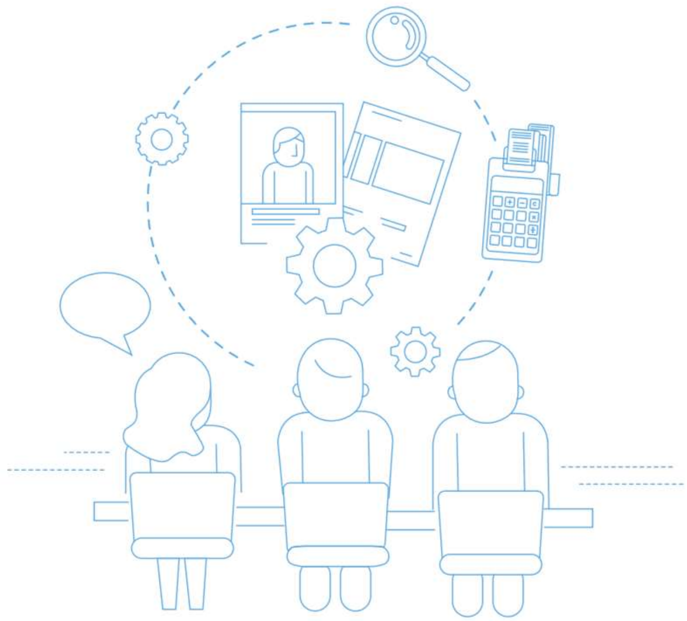
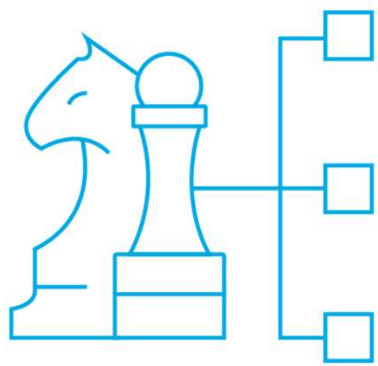
Considerations



- Take advantage of the “pre-regime years” election
  - Taxpayer and eligible group entities jointly elect to compute EIFEL as if it applied for the previous three years
  - If you would have had excess capacity in the pre-regime years, can include amounts in cumulative unused capacity available for use in the first regime year and potentially onwards

Next steps

- Determine whether corporate group or related trusts are “excluded entities”
- Model non-deductible IFE and understanding expected impact
- Consider a group ratio election
- Consider a single-member group ratio election
- Determine a starting balance of deduction capacity with a pre-regime years analysis



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The OECD’s two-pillar solution

The OECD's two-pillar solution

Reshaping the international tax system

Pillar 1 *Allocating profit between group entities*	Amount A	*Revenues of at least €20bn and profit of at least 10%*	*Reallocates profits over 10% to market jurisdictions where nexus test met*
	Amount B	*Potentially all entities within transfer pricing rules*	*Sets formulaic approach to reward baseline distribution activities*
	Amount C	*Application to be confirmed – may align with Amount B*	*Remunerates additional local activities and provides dispute resolution mechanisms*

Pillar 2 *Global minimum tax rate of 15%* *Revenues of at least €750m in two out of four prior years*	Multinational Top-Up Tax	Income Inclusion Rule
		Undertaxed Profits Rule
	Subject To Tax Rule	
	Domestic Minimum Tax	

Pillar One Amount B

Rewarding baseline distribution activities

- Introduces a formulaic return to determine remuneration for baseline distribution activities in a territory
- Seeks to simplify compliance by removing the need for the business to perform benchmarking analysis in respect of distribution activities
- To be included in the transfer pricing guidelines as requirement or safe harbour

Calculation steps

01

Characterisation

- Identify activities meeting definition of baseline distribution activities
- Stream results where required

02

Matrix of expected profit margins

- Locate appropriate level of return on matrix, based on three industry groupings and five levels of factor intensity
- EBIT margins between 1.5% and 5.5% on OECD's matrix

03

Cap and collar

- Berry ratio calculation
- Designed to address high or low intensity activities

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Pillar One Amount B

Expected returns

Baseline distribution margins

Factor intensity / Industry grouping	Industry grouping 1	Industry grouping 2	Industry grouping 3
[A] High OAS/ any OES >45% / any level	3.50% +/- 0.5%	5.25% +/- 0.5%	5.50% +/- 0.5%
[B] Med/high OAS / any OES 30% - 44.99% / any level	3.25% +/- 0.5%	3.50% +/- 0.5%	4.50% +/- 0.5%
[C] Med low OAS / any OES 15% - 29.99% / any level	2.75% +/- 0.5%	3.25% +/- 0.5%	4.25% +/- 0.5%
[D] Low OAS / non-low OES <15%/10% or higher	2.00% +/- 0.5%	2.25% +/- 0.5%	3.00% +/- 0.5%
[E] Low OAS / low OES <15% OAS / <10% OES	1.50% +/- 0.5%	1.75% +/- 0.5%	2.25% +/- 0.5%

Net operating asset intensity (OAS) refers to the ratio of net operating assets to net revenue, expressed as a percentage.

Operating expense intensity (OES) refers to the ratio of operating expenses to net revenue, expressed as a percentage.

Industry groupings

Group 1

Industry categories which have a statistically significant relationship to lower levels of return.

Examples include: perishable foods, grocery, household consumables, alcohol and tobacco, construction materials and supplies

Group 2

Industry categories which do not show a statistically significant relationship to levels of return.

Examples include: domestic vehicles, IT hardware, software, electricals, plastics and chemicals and any components not listed under Group 1 and 3

Group 3

Industry categories which have a statistically significant relationship to higher levels of return.

Examples include: pharmaceuticals, medical supplies and machinery, industrial tools and supplies, industrial and domestic vehicles (incl. parts and supplies)

Pillar One Amount B

Key issues and challenges

01 Achieving agreement on characterisation of activities

02 How does Amount B return compare to current reward for group distribution activities?

03 What is the impact on the residual profit in the counterparty / principal?

04 Identifying local variations – where an alternative matrix or sovereign debt adjustment are used

05 Operational mechanics, including streaming results and aligning day-to-day charging with Amount B margin

06 Interaction of business model with Amount B expectations, eg. high volume low margin distribution

- Amount B rules under consultation during Summer 2023
- Clarification on method of characterisation to follow
- May be introduced as either compulsory or safe harbour
- Expectation that final requirements will be inserted into Transfer Pricing Guidelines during 2024
- Territories where rules linked to Guidelines may be obliged to adopt Amount B requirements as a result

Pillar One Amount C

Overview

Amount C seeks to:

- Reward in-country functions which exceed the baseline activity under Amount B, for example more valuable marketing intangibles
- Provide binding dispute resolution

Key issues

A number of key questions relating to Amount C remain to be resolved, in particular:

01

Who will it apply to? As an implied extension of Amount B, this could apply to all

02

Will a finalised Amount C be a critical component of introducing either Amount A or Amount B?

Pillar Two

Overview – key points

01

Global minimum tax rate 15%

02

Annual revenue of at least €750m

(in two of four prior years)

03

Accounting periods starting after 31 December 2023

04

Single 'GloBE return' for the group

05

Calculation on an entity basis, aggregated by territory

06

Based on financial reporting in formation

07

Safe harbours and excluded entities

Including transitional rules based on CbCR data

08

Shortfall collected under Income Inclusion Rule, Undertaxed Profits Rule or Domestic Minimum Tax

Key risk areas:

- Top-up tax drives additional liability
- Onerous reporting requirement
- Management of stakeholder expectations

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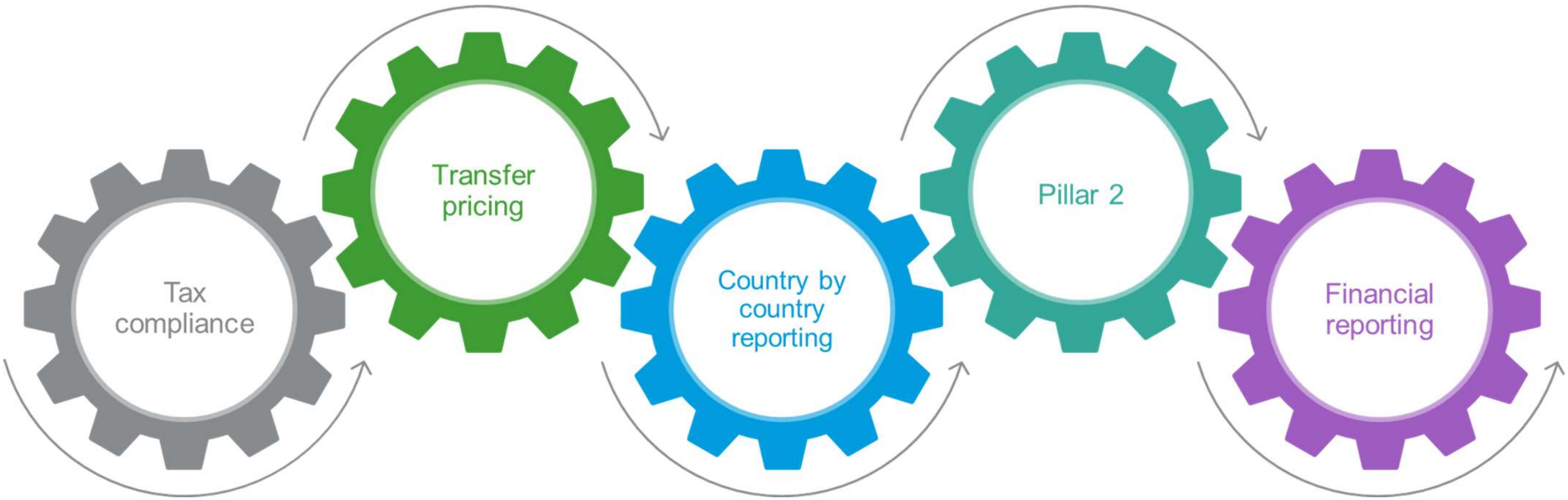
Pillar Two


Tax compliance
Transfer pricing
Country by country reporting
Pillar 2
Financial reporting

Pillar Two

CbCR safe harbour (transitional)

Simplified safe harbour for periods starting no later than 31 December 2026 and ending no later than 30 June 2028

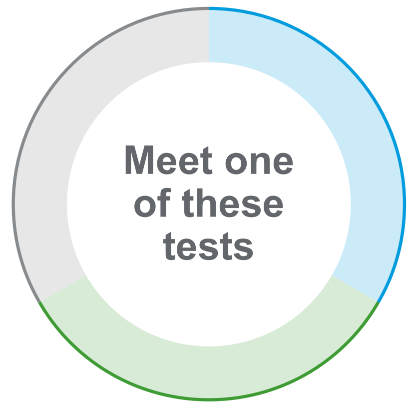
Looks at results by jurisdiction

Based on CbCR data

Detailed provisions can apply to specific situations

Routine profits test

- Profit or loss before income tax equal to or less than the substance-based income exclusion in that jurisdiction under CbCR, calculated under the GloBE rules



De minimis

- CbC revenue less than €10m
- CbC profit less than €1m (or loss)

Simplified ETR test

- Simplified ETR is the simplified current taxes (income tax in financial statements less taxes that are not covered taxes and taxes relating to uncertain tax positions)
- Transition rate is:
  - 15% for fiscal years beginning in 2023 and 2024
  - 16% for fiscal years beginning in 2025
  - 17% for fiscal years beginning in 2026

Pillar Two

Key areas to address

- Impact modelling
- Tax risk assessment

- Reporting process set up
- Timetable to first period
- Feedback loop from the business

- Internal – data availability and robustness
- External – OECD and national updates

- Local finance teams
- Management and audit committee
- Auditors

- Reporting systems
- IT requirements/ budget
- Lead time for systems updates

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Pillar Two

Addressing the challenges of Pillar Two

We can support your business throughout its Pillar Two journey

This can be tailored to your requirements and where you are in the process

It is critical for Pillar Two to be addressed in the context of your financial reporting and tax governance to build a consistent, robust and practical platform going forward

01

Understanding the impact of Pillar Two on your business

Including the application of the rules, areas of uncertainty and likely risk areas

02

Impact modelling

Using CbCR and other available data to understand likely top-up tax impacts for engagement with stakeholders and financial reporting

03

Designing and implementing a robust reporting process

Understanding and mapping your data requirements and key stakeholder responsibilities; setting processes and controls

04

Ongoing monitoring and improvements

Identifying new tax legislation and enhancements to provide advice for your evolving global reporting process.

International tax updates

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Sections 15 and 90 – updates to shareholder debt and loans from foreign affiliate rules

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Overview

- Subsection 15(2) of the Act requires that certain shareholder indebtedness be included in the income of the debtor in the year in which the indebtedness arose.
- Where the debtor is a non-resident of Canada, subsection 15(2) in conjunction with subsection 214(3) of the Act deems a dividend subject to non-resident withholding tax to be payable under Part XIII of the Act.

Old rules

- Subsection 15(2.3) provided an exception in respect of a loan made in the ordinary course of a lender's ordinary business of lending money, provided *bona fide* arrangements were made at the time the indebtedness arose or the loan was made for its repayment within a reasonable time.

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Sections 15 and 90 – updates to shareholder debt and loans from foreign affiliate rules

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New rules

- Subsection 15(2.3) is amended to exclude from the money lending business exception any business if, at any time during which the particular loan is outstanding, less than 90 percent of the aggregate outstanding loans of the business are owing by borrowers that deal at arm's length with the lender.

Application

- Loans made after 2022 and the portion of loans made before 2022 that are outstanding on Jan. 1, 2023.

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Sections 15 and 90 – updates to shareholder debt and loans from foreign affiliate rules

Old rules

Subsection 90(6) provides for the inclusion of “specified amounts” in the income of a taxpayer resident in Canada where loans are made by a “creditor affiliate” or a “creditor partnership” of the taxpayer to certain “specified debtors”.

Paragraph 90(8)(b) provides an exception in respect of loans made in the ordinary course of a creditor’s ordinary business of lending money.

New rules

Paragraph 90(8)(b) is amended to exclude from the money lending business exception a business if, at any time during which the particular loan is outstanding, less than 90 percent of the aggregate outstanding loans of the business are owing by borrowers that deal at arm’s length with the creditor.

Application

Loans made after 2022 and the outstanding portion of loans made before 2022 that are outstanding on Jan. 1, 2023

General overview – Canadian withholding tax

Current WHT rules

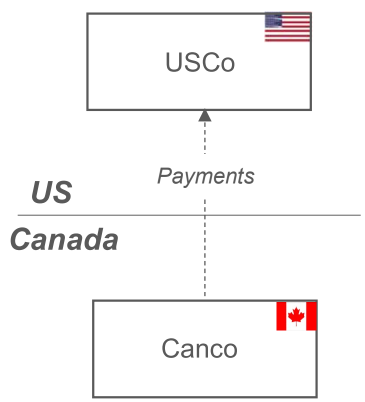
25% withholding tax
on certain payments*

From
A Canadian resident "person"

To
A non-resident "person"

**subject to reduction under an applicable tax treaty*

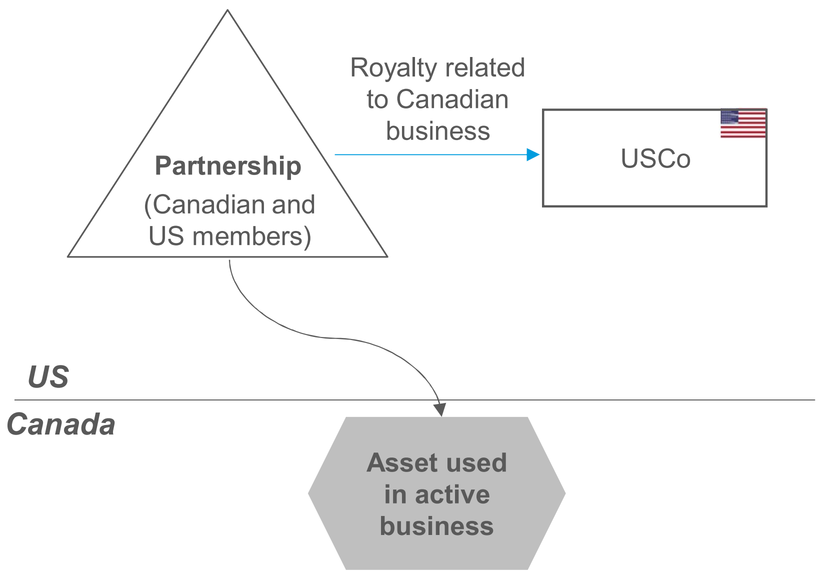
Illustration of a typical transaction



Some examples of payments liable for withholding

- Dividends
- Interest
- Management fees
- Royalties

Withholding tax for partnerships – current rules



- However, a partnership is not a “person” under Canadian tax rules.
- Instead, there are deeming rules that may subject certain payments made by a foreign partnership to Canadian WHT.
- The WHT obligations of a partnership are linked to the partnership's Canadian-source income.
  - If a partnership has Canadian-source income, it will generally be subject to WHT on certain payments.
  - But if there’s no Canadian source income, then there’s generally no WHT.

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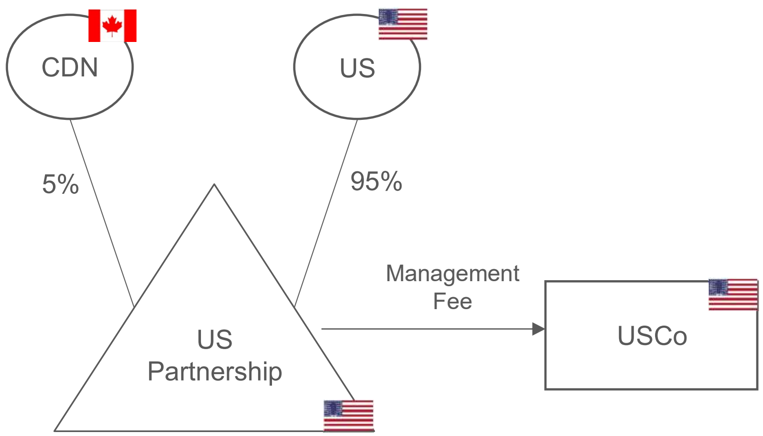
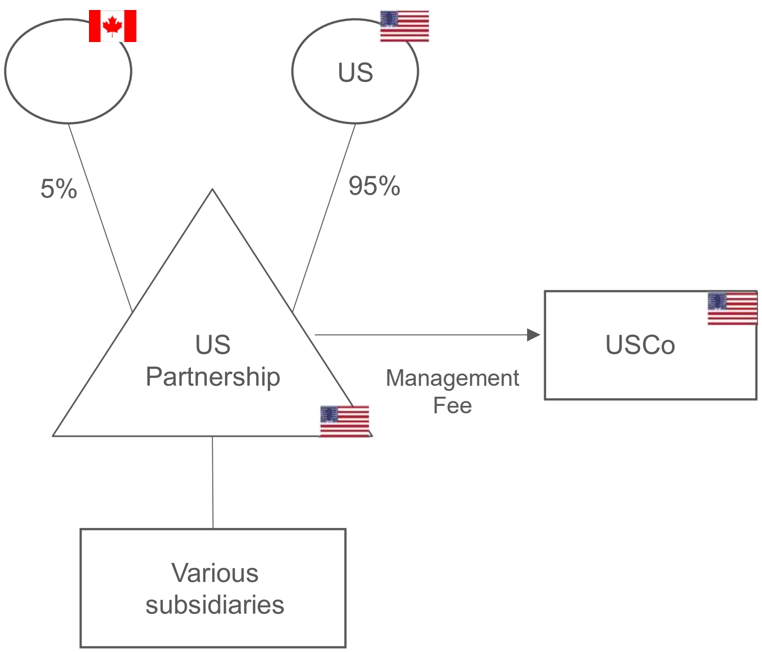
Withholding tax for partnerships – proposed rules



- A foreign partnership may be deemed to be a resident of Canada in respect of the portion of an amount paid to a non-resident person where that amount is deductible in computing a Canadian partner’s share of partnership income which is subject to tax in Canada.
- If enacted, these proposals would require a foreign partnership to withhold even if it does not have any Canadian-source income.

Proposed rules – Example



Partnership	
Gross Income	1,000
Management Fee	400
Partnership Net Income	600
Canadian partner's allocation	
Pro rata partnership income	50
Pro rata management fee deduction	20
Canadian partner's net income	30
Amount subject to Canadian WHT	20
Withholding tax	25%
Canadian WHT liability of US partnership	5

THANK YOU FOR YOUR TIME AND ATTENTION

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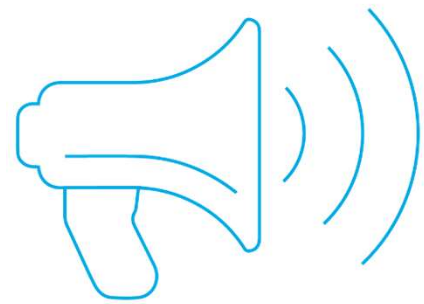
See you soon!

Coming up later today:

- **3 p.m.**
  Thriving in the Canadian GST jungle

Click on the 'Register now' button on the right of the screen



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