ITAX – Canadian Tax Update

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Topics

- Excessive Interest and Finance Expense Limitation (EIFEL)
- Digital Service Tax (DST)
- Global Minimum Tax (GMT)

Excessive Interest and Finance Expense Limitation (EIFEL)

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EIFEL

- EIFEL rules are designed to limit the amount of interest and financing expenses a business can deduct from its taxable income.
- They apply to tax years that start on or after October 1, 2023. The legislation enacting the rules received Royal Accent on June 20, 2024.
- For taxation years starting after October 1, 2023, and before January 1, 2024, impacted businesses can only deduct interest and financing charges up to 40% of their tax adjusted EBITDA. For tax years starting after January 1, 2024, the limit is 30% of their tax adjusted EBITDA.

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EIFEL

- EIFEL rules apply to corporations and trusts, other than an excluded entity.
- Excluded entities include:
  - Canadian controlled private corporations (CCPCs) that have taxable capital in Canada of less than $50M CAD.
  - Eligible groups of Canadian resident corporations and trusts whose aggregate **net** interest and financing expenses are less than $1M CAD.
  - Canadian corporations and trusts that carry on more than 90% of their business in Canada, and certain other conditions are met.

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EIFEL

- While the basic concept is that a business can deduct interest and financing expenses up to 30% of its tax adjusted EBITDA, the calculation is multi-layered.
- The following formula is used to determine the non-deductible amount:

  (A-(B+C+D+E))/F

  - A = the taxpayer’s interest and finance expense (IFE)
  - B = the taxpayer’s adjusted taxable income multiplied by the fixed ratio
  - C = taxpayer’s interest and finance revenues
  - D = taxpayer’s received capacity
  - E = taxpayer’s absorbed capacity
  - F = taxpayer’s IFE with possible adjustments

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EIFEL

- Received capacity – under a joint election a group member can transfer available unused excess capacity to a taxpayer.
- Absorbed capacity – unused excess capacity carried forward from prior years. [Note: carry forward period is only three years]
- Denied expenses can be carried forward and deducted in a future year where there is capacity available. [Note: carry forward period is indefinite.]
- Taxpayers are required to file a prescribed form with their tax return to report details on the deductibility of their IFE. The normal reassessment period for the EIFEL rules do not begin until a completed form is filed. – Form just released and is 24 pages long.

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Digital Service Tax (DST)

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DST

- Canada enacted the Digital Services Tax Act on June 20, 2024, and came into effect on June 28, 2024.
- The DST is a 3% tax on revenue from digital services provided in Canada by large companies (domestic and foreign).
- The tax is retroactively applied to digital service revenue earned since January 1, 2022.
- Companies required to pay the DST will need to report their liability by June 30, 2025, for calendar years 2022, 2023 and 2024.

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DST

- Digital service revenue that is subject to the tax includes revenue earned from:
  - Online marketplace services
  - Online advertising services
  - Social media services
  - Certain sales or licensing of user data
- DST applies to companies with global consolidated revenue of €750M or more, and more than $20M CAD in digital revenues generated in Canada

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DST

- Companies must register for the DST if:
  - They have Canadian digital services revenue greater than NIL in the calendar year; and
  - They had or was a member of a consolidated group that had, total revenue of at least €750M during the year; and
  - They had or was a member of a consolidated group that had, total Canadian digital services revenue of at least $10M CAD in the year.
- **Note: registration is required at a lower threshold of Canadian digital services revenue than the requirement to pay the tax.**

DST

- Information on how to register for the DST has not yet been released. It is expected before the end of 2024.
- Information on how to file a return will be available in early 2025.
- **Note**: the DST is separate from the Canadian digital sales tax regime implemented on July 1, 2021. Starting on that date, foreign digital service providers and e-commerce platforms became responsible for registering, collecting and remitting the Goods and Services Tax (GST) or Harmonized Sales Tax (HST) on sales to Canadian consumers if their sales exceeded $30,000 CAD over a 12-month period.

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DST

- **At the end of August 2024, the US announced that they are taking steps to challenge the DST as a violation of the US-Mexico-Canada Agreement.**

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Global Minimum Tax (GMT)

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GMT

- The GMT rules are Canada’s version of the OECD Pillar Two.
- They received Royal Assent on June 20, 2024.
- They are generally effective for fiscal years that begin on or after December 31, 2023. The first return and potential taxes are due as early as June 30, 2026.
- The GMT rules are intended to ensure large multinational enterprise (MNE) groups pay a minimum effective tax rate [ETR] of 15%.
- Additional legislation proposes an amendment to the Income Tax Conventions Interpretation Act that would ensure that applying a provision of a tax treaty would not prevent the application of the GMT.

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GMT

- GMT rules would apply for a particular fiscal year if the following are met:
  - The MNE has at least one entity or permanent establishment located in Canada.
  - The revenue reported in the group's consolidated financial statements is €750M or more in at least two of the four immediately preceding fiscal years.
  - The group is not composed entirely of excluded entities (NPOs, pension funds, ultimate parent entities that are real estate investment vehicles or investment funds).

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GMT

- The top-up tax is collected in one of the following ways:
  - Qualified domestic minimum top-up tax [QDMTT]: entities in Canada are subject to a domestic top-up tax where the MNE’s group Canadian ETR is below 15%.
  - Income inclusion rule [IIR]: the ultimate parent entity is generally subject to the top-up tax in respect of income earned in a foreign country, where the MNE’s group’s ETR in respect of that country is below 15%. Where the ultimate parent is resident in Canada, Canada should impose the IIR. However, if that foreign country has a QDMTT in place, tax under the IIR is generally deemed to be NIL.

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GMT

- In addition to the QDMTT and IIR, a proposed undertaxed profit rule [UTPR] would subject in-scope Canadian entities within an MNE group to a top-up tax on foreign-sourced undertaxed profits where an IIR or QDMTT doesn't apply to those profits. The UTPR may apply where the ETR in a foreign jurisdiction is less than 15%, that foreign jurisdiction does not have a QDMTT, and there's no ultimate parent entity or intermediate entity in respect of the entity that earned the undertaxed profits.

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GMT

- Safe harbour provisions:
  - Permanent QDMTT safe harbour – this rule deems the top-up tax to be nil for a participating entity in the MNE group if that entity is in a jurisdiction with an acceptable QDMTT in place and a valid election is filed.
  - Permanent simplified calculations safe harbour – this rule deems the top-up tax to be nil for an MNE group's non-material constituent entities for a particular jurisdiction, provided certain conditions are met and a valid election is filed.
  - Transitional country-by-country reporting safe harbour – this rule generally deems the top-up tax amount to be nil for certain low-risk jurisdictions and simplifies calculations for that jurisdiction if certain conditions are met and a valid election is filed.

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GMT

- Additionally, there is a proposed transitional UTPR safe harbour – this rule deems the top-up tax to be nil for each constituent entity and joint venture in respect of the MNE group that is located in the ultimate parent entity jurisdiction if certain conditions are met and a valid election is filed.

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GMT

- Filing obligations:
  - An in-scope MNE will have filing obligations with the Canada Revenue Agency (CRA). The filings and any taxes owing are generally due 15 months after the particular fiscal period.
  - The GloBE Information Return (GIR) – discloses certain information on the MNE group in accordance with the OECD's standardized return. If the MNE group has a designated filing entity in Canada, the GIR must be filed with the CRA.
  - Separate returns for the QDMMT, IIR or UTPR will be filed in Canada if top-up taxes apply.
  - Penalties apply for late and non filing. For the GIR, the late filing penalty is $25,000 per month to a maximum of $1M CAD.

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Thank you

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