

# Canadian tax updates Structuring: A case study

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# Topics

- Digital Services Tax (DST)
- Global Minimum Tax (GMT)
- Structuring: A case study



# Digital Services Tax (DST)

# DST: About the tax

- 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.

# DST: What does it apply to?

Digital services 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

# DST: Required registration

- Companies must register for the DST if:
  - They have Canadian digital services revenue greater than NIL in the calendar year; and
  - They had or were a member of a consolidated group that had total revenue of at least €750M during the year; and
  - They had or were 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: How to register

- You must use the DST account registration web form to apply to register for your DST program account.
- Designated entity election: Foreign or domestic businesses that must file a DST return may make a designated entity election for a given year.
  - Election allows you to designate another entity in your consolidated group to act on your behalf for the year.
  - Several members of your consolidated group can elect the same entity on the same election.
  - Only an entity that has applied to register for a DST program account can be designated. Registration is possible even if the entity does not meet all the registration thresholds.
  - To be valid for a calendar year, the election must be made **by June 30** of the following year.

# DST: Filing a return



You must file a DST return through an Application Programming Interface (API) using a JavaScript Object Notation (JSON) schema.



DST returns are due annually on or before June 30 of the following calendar year.



A foreign or domestic business **must file a DST return** by June 30, 2025, if for any one of the 2022, 2023, or 2024 calendar years.



# DST: Interest and penalties

## Penalty

If you fail to file a DST return when required, you are liable to pay a penalty equal to the total of:

- 5% of the tax for the year that was unpaid when the return was required to be filed, and
- 1% of the tax for the year that was unpaid when the return was required to be filed, for each complete month (not exceeding 12 months) in which the return is not filed.

## Interest

If you fail to pay an amount, interest will apply from the day your payment was due. The interest rate we use is determined every three months based on prescribed interest rates. Interest is compounded daily.

# DST: What's next?

- At the end of August 2024, the US announced that it would be taking steps to challenge the DST as a violation of the US-Mexico-Canada Agreement.
- In May 2025, the House passed the One Big Beautiful Bill Act, which adds a new Code section 899, "Enforcement of Remedies Against Unfair Foreign Taxes"
  - The DST would be included as an Unfair Foreign Tax, and as a result, Canada is on the list of countries that will be impacted by section 899.
  - Section 899 would impose a 5% increase in 1st tax year on the applicable tax rate on the income and would continue to increase 5% each year that the DST remains in place, up to 20% above the statutory rate.
  - For income subject to a tax treaty, the 5% would be in addition to the treaty rates.
    - Exception applies to income that is explicitly excluded from tax under the treaty, such as portfolio interest.

# Global Minimum Tax (GMT)

# GMT: About the tax

- 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 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.

# GMT: When does it apply?

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).

# GMT: Top-up tax

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.

# GMT: Undertaxed profit rule (proposed)

- 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.

# GMT: Safe harbor 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.



# GMT: Safe harbor provisions (proposed)

- 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.

# 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.
- **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.

# Structuring: A case study

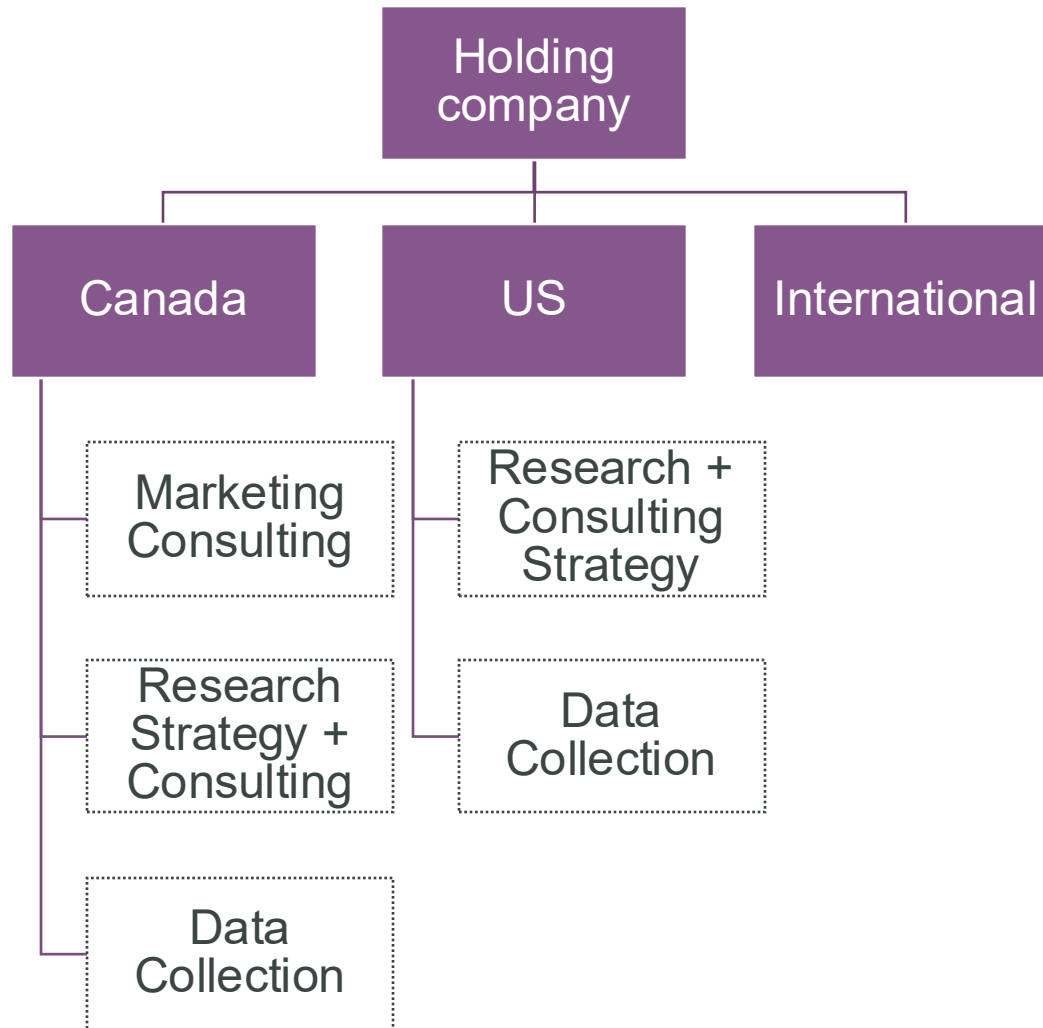
# Facts and assumptions

- New venture – a marketing company focusing on data collection and analytics with IP generation.
- Two key partners – a Canadian resident individual and a US resident individual.
- Stock options for key employees.
- Clients and employees in the US and Canada.
- Exit in 5-10 years with a projected valuation of \$20 million.

# Objectives

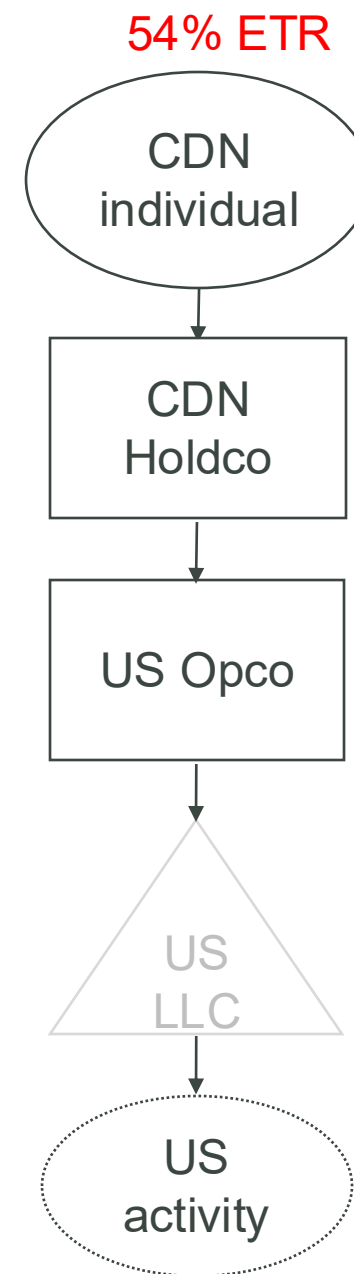
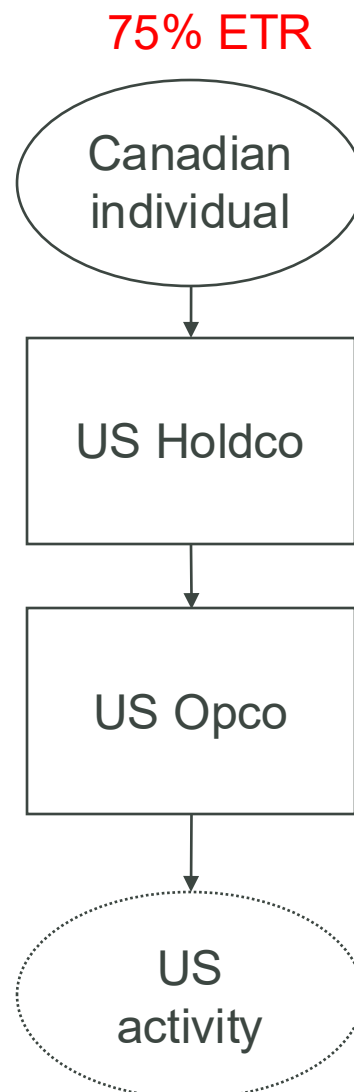
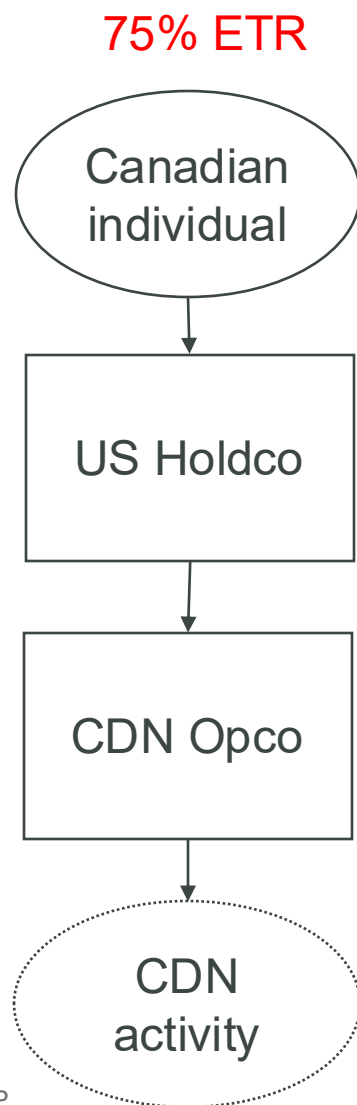
- Structure that minimizes taxes on extracting funds and on exit from a US and Canadian tax perspective.
- Structure that provides both shareholders equal interest in US and Canadian business.
- Ability to maximize government R&D incentives.

# Client suggested structure

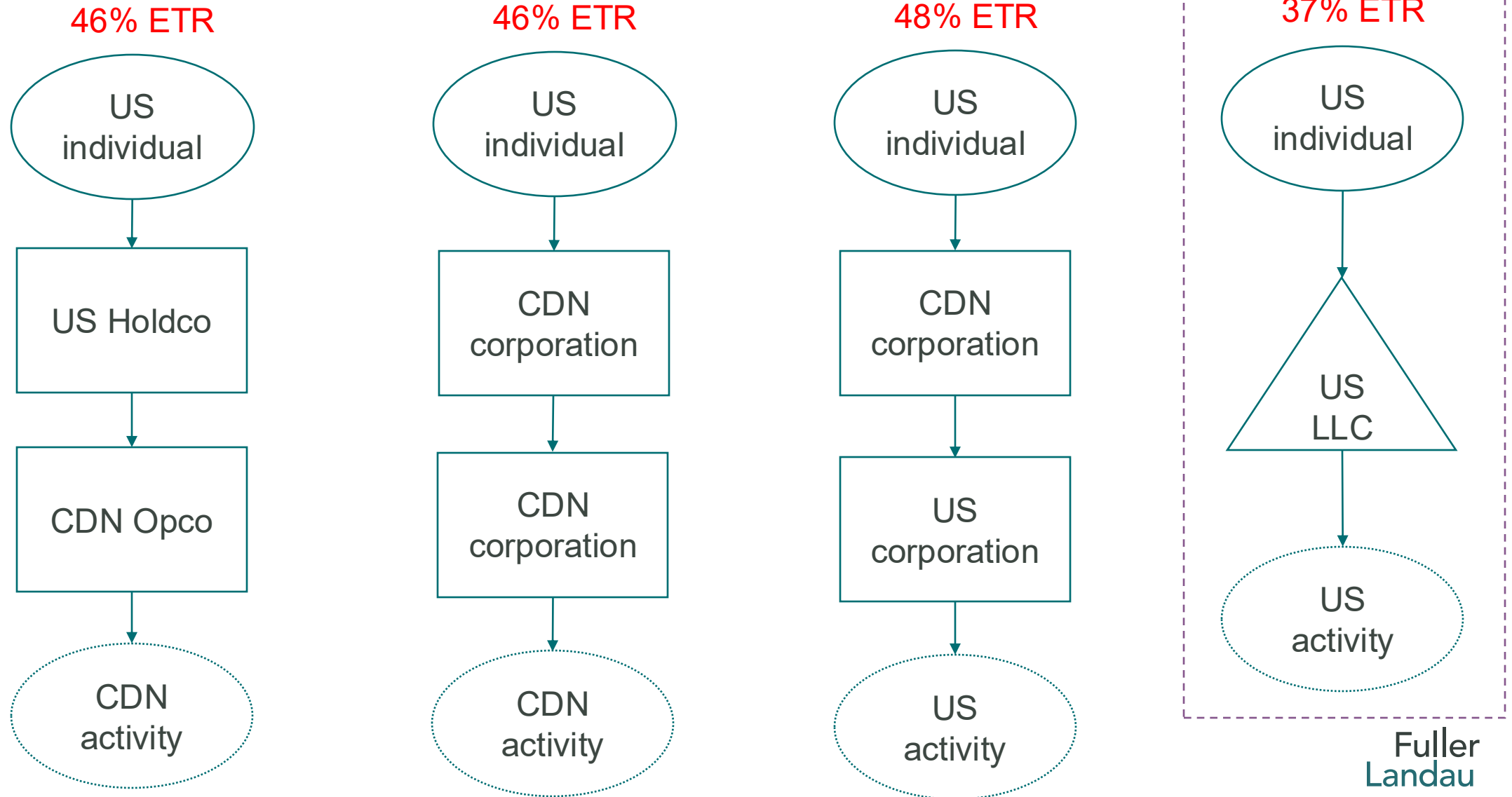


- Residency of Holding company?
- Where should the IP reside?

# Canadian individual shareholder

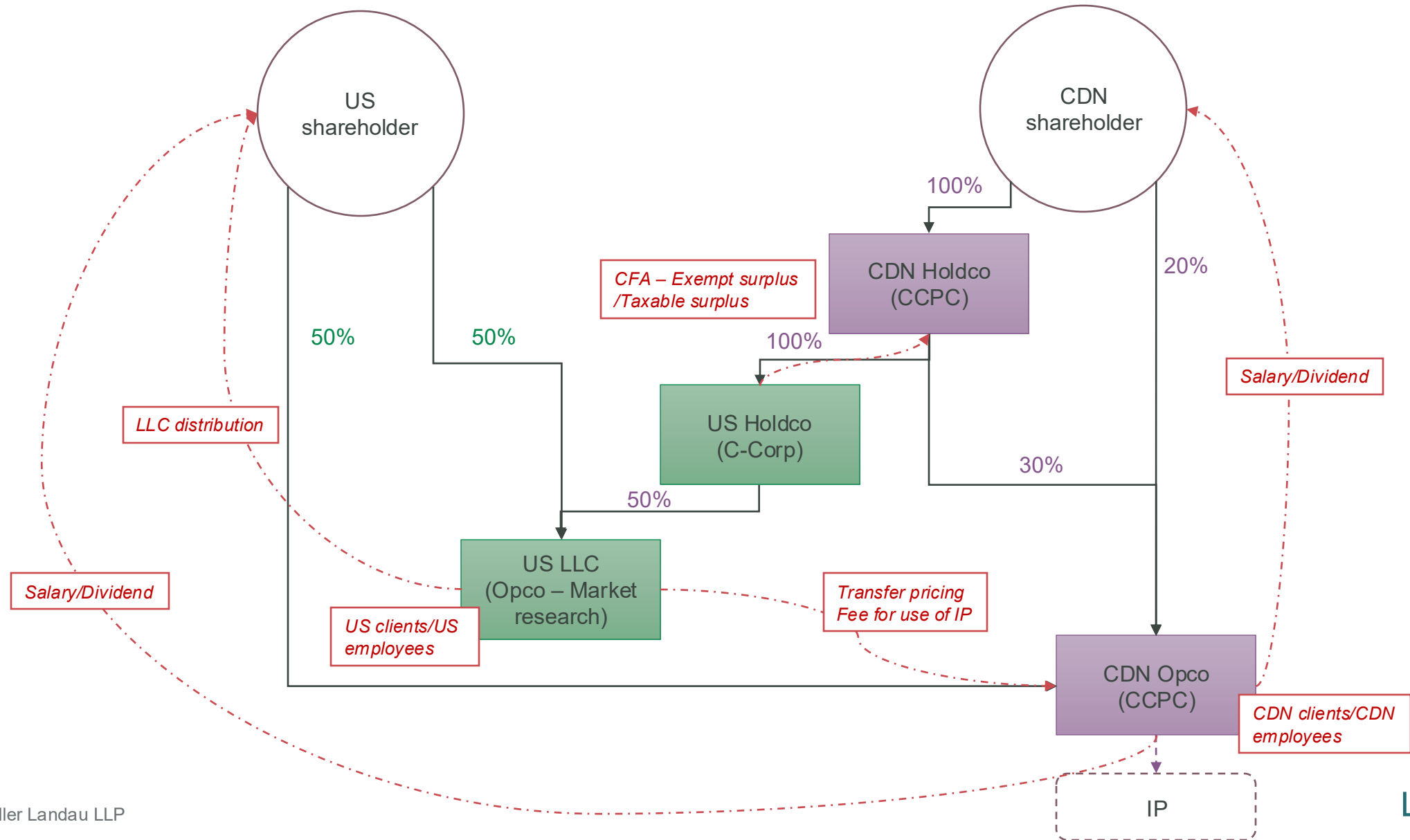


# US individual shareholder





# Proposed structure



# Canadian tax considerations

- Canadian controlled private corporation status
- Corporate level:
  - Lower corporate tax rate on first \$500,000 of active business income
  - Enhanced SR&ED credits

Entity type	ITC rate	Refundable portion of ITC	Expenditure limit
Non-CCPC private corporation	15%	Nil	N/A
CCPC	35%	100%	\$3 million of qualifying SR&ED expenditures
	15%	40%	Qualifying SR&ED expenditures over \$3 million or the reduced limit

- Individual level (CDN taxpayer)
  - Lifetime capital gains exemption – \$1,250,000 CDN capital gains exemption for QSBC shares
  - Preferable treatment on stock options

# US tax considerations

- CDN Opco is a CFC – 80% owned direct and/or constructively by US shareholders.
  - 50% direct ownership by US shareholder.
  - 30% constructive ownership by US Holdco through CDN Holdco – due to repeal of 958(b)(4).
  - Subpart F and/or GILTI will apply on revenue of CDN Opco for US shareholder. High-tax Election would likely apply. 962 Election would also be available.
- Qualified small business stock - \$10,000,000 USD capital gain exemption.
  - US Opco:
    - Elect corporate tax treatment under check-the-box regulations.
    - Shares held for more than 5 years after conversion to a corporation.

# Effective tax rates (\$20 million valuation)

	CDN individual	US individual
Repatriation of earnings from US LLC (exempt surplus)/allocation of earnings from US LLC	54%	37%
Repatriation of earnings from US LLC (taxable surplus)	55%	NA
Salary from Canadian Opco	54%	37%
Dividend from Canadian Opco	53% - 55%	44%
Sale of LLC interest	31%	20%
Sale of Canadian Holdco shares	29%	NA
Sale of Canadian Opco shares	20%	24%
Sale of LLC/Holdco/Opco	42%	22%

*\*Assumes highest US federal marginal tax rates and 5% state tax.  
Assumes Canadian highest marginal tax rates for ON resident individuals.*

# Thank you