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*June 2017*

# Canada signs Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent BEPS

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Canada has over 90 bilateral tax treaties and over 20 bilateral Tax Information Exchange Agreements in force, with at least a dozen more treaties or agreements in the negotiation stage. This fact alone highlights the importance such agreements play on the global tax stage. Not surprisingly, Canadian multinationals and Canadian subsidiaries of foreign multinationals have long understood the impact tax treaties may have on how their cross-border intergroup transactions will be taxed.

Yet in spite of their overall importance, updating tax treaties on a regular basis to ensure they take into account the most recent version of the Model Tax Convention issued by the Organisation for Economic Co-operation and Development (OECD) has not been possible since Canada would need to enter into separate negotiations with each of its treaty partners. Even reasonably simple changes have taken years to implement. For example, the negotiations that led to the 2007 changes to the Canada-U.S. tax treaty commenced in 2000.

*Removing the roadblock*

On June 7, 2017, Canada and over 70 other countries agreed to remove the renegotiation roadblock by signing the *Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting* (the "MLI"). To be certain, its purpose is to provide countries with a way to upgrade their existing treaty to meet the Base Erosion and Profit Shifting ("BEPS") minimum standards in the areas of treaty abuse and dispute resolution without the need to renegotiate the treaty itself.

The MLI's ability to bypass the usual renegotiation process is attributed to the following:

1. Several options were developed that would allow a treaty to meet the BEPS minimum standard for treaty abuse and dispute resolution; and
2. Each of the signatories have already agreed to the wording for each of the provisions required to implement each of the options.

Upon signing the MLI, Canada was required to indicate which of the options it would use to meet the BEPS minimum standards with respect to treaty abuse and dispute resolution. This choice would not prevent Canada from using other options when the actual treaty was renegotiated.

*Dealing with treaty abuse – the principal purpose test*

Canada chose to use the principal purpose test to combat treaty abuse. The test, which looks at whether one of the principal purposes of a transaction or series of transactions is to obtain treaty benefits in a manner that goes against the object and purpose of the relevant treaty, is similar to the general anti-avoidance rule found in Canada's domestic income tax legislation. As each of our treaties are renegotiated, Canada has indicated that it will seek to include a limitation of benefits provision similar to the one found in the Canada-U.S. tax treaty.

Multinational organizations would be well advised to revisit the principal purpose of their more complex cross-border transactions and structures to ensure that the primary purposes thereof are not related to obtaining tax benefits.

*Mandatory binding arbitration option chosen to resolve treaty disputes*

Canada's experience with mandatory binding arbitration under the Canada-U.S. tax treaty likely influenced our choice of this method to resolve treaty disputes under the MLI.

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*What next?*

It will still take some time before the MLI enters into force. Even after the MLI is ratified by Canada, it would only apply to a specific treaty after its ratification in the relevant foreign jurisdiction. The federal Department of Finance has indicated that the earliest the MLI would come into force would be January 1, 2019.

Canada has already submitted a list of over 75 bilateral treaties that will be impacted by the MLI once Canada and the relevant treaty partner both ratify the MLI. Our treaties with Germany, Switzerland and the U.S. were noticeably absent from that list. In the case of the first two countries, those treaties are currently being renegotiated and the relevant provisions will be incorporated into the actual treaties. In the case of the U.S., the current treaty already meets or exceeds the BEPS minimum standards in the areas of treaty abuse and dispute resolution.

*In summary*

The process that led to the adoption of the MLI has provided governments and their national tax authorities an effective way of expediting tax treaty-related changes without first engaging in lengthy country-by-country renegotiations. This will allow them to respond much faster to close any loopholes in these agreements.

Multinational organizations should take the time over the next year or two prior to the MLI coming into force to review their business structures and transactions. Where these would no longer meet the principal purpose test, action should be taken to bring things back onside.

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