Deloitte.

Bay Adelaide East
8 Adelaide Street West
Suite 200
Toronto ON M5H 0A9
Canada

Tel: 416-601-6150
Fax: 416-601-6151
www.deloitte.ca

November 15, 2023

Peter Repetto
Senior Director of International Outbound Taxation
Tax Legislation Branch
Department of Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Via email peter.repetto@fin.gc.ca

Re: Accounting standards for private enterprises – Impact on ultimate parent entity determination under the *Global Minimum Tax Act*

Dear Peter,

We are writing to provide our comments regarding the role of accounting standards for private enterprises (ASPE) in ultimate parent entity (UPE) determinations under the *Global Minimum Tax Act*[1] (GMTA) in connection with the previously issued public consultation announced on August 4, 2023, in relation to the draft GMTA. Notwithstanding the formal close of public consultations on September 29, 2023, we wanted to share our comments to help inform the development of the GMTA.

Deloitte and its affiliated entities constitute one of the largest professional services firms in Canada. We work with many taxpayers, ranging from individuals and private businesses to Canadian and global multinationals, to advise and support them in meeting their compliance obligations under the Act. We are pleased to provide feedback on the draft GMTA, specifically through the perspective of tax practitioners who regularly interact with and advise taxpayers, including privately held organizations that may be subject to the GMTA directly or indirectly.

When initially preparing our comments, we were of the view that the accounting policy choice not to consolidate under ASPE was, subject to the Department of Finance confirming such interpretation, consistent with the draft legislation released on August 4, 2023 (as well as the OECD Rules,[2] Commentary,[3] and

---

[1] Canada, Department of Finance, *Legislative Proposals Relating to the Global Minimum Tax Act* (Ottawa: Department of Finance, August 4, 2023).
[2] OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.
[3] OECD (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf (hereinafter the "OECD Commentary (2022)").

Administrative Guidance[4]) and resulted in the appropriate tax policy outcomes, subject to valid concerns about the potential for private company tax avoidance. We now understand that this view may not be the intention of the Department of Finance with respect to UPE determinations, nor may it be consistent with the views of the OECD. Moreover, we understand the Department of Finance may be contemplating changes in the GMTA that would clarify the intention that consolidated financial statements presume line-by-line consolidation of controlled subsidiaries unless investment company (entity) accounting criteria are satisfied.

Although we are no longer seeking the Department of Finance's confirmation of our view, we continue to believe that findings that private investment entities (PIEs) are UPEs of public companies controlled by them will produce inappropriate tax results and at the same time impose substantial compliance and administrative burdens.

The issue

In Canada, it is public information that several public companies have controlling shareholders (often families). In many cases, although not always public information, the entities which own the controlling stakes are private companies or trusts, often through layers (tiers) of entities reflecting the different ownership and control over group (family) assets by different family members and external partners and co-investors. These entities typically do not consolidate the controlled public company (Pubco) for financial statement purposes. Such financial statements are, more often than not, prepared in accordance with ASPE, which permits but does not require consolidation in these circumstances.

This letter addresses whether the UPE for purposes of the GMTA (hereafter referred to as "Pillar Two") is (should be) the PIE, which holds the controlling stake in the Pubco, or the Pubco. We come to the overall conclusion that the Pubco is (should be) the UPE based on the text, context, and purpose of the relevant provisions of the draft GMTA. This conclusion applies only in cases where there is no required line-by-line consolidation of the Pubco at the PIE level, as permitted by ASPE. If there were line-by-line consolidation at the PIE level – likely because an external stakeholder required it and reflecting the notion that the PIE in fact exercises its control over the Pubco more like a parent entity than in an investment or stewardship role – the PIE would be the UPE. In summary, we were of the view that, while no further OECD guidance was required, confirmation or clarification of this interpretation in Canada would be important for the reasons set out below.[5]

Factual context

The PIEs in this context are usually investment holding entities with board representation and management involvement at the Pubco level – where the business of the Pubco is actually run – as appropriate. The PIEs that hold these controlling stakes in Pubcos do not typically consolidate because i) there is no requirement under ASPE to consolidate subsidiaries (i.e., this is an accounting policy choice rooted in simplicity), and ii) there is no family planning or commercial imperative to consolidate (note here that the quality of the financial statement information is not compromised from the standpoint of the stakeholders). For example, if there was debt owing at the PIE level, the Pubco shares may serve as collateral; however, the lenders in these cases

---

[4] OECD (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf as amended from time to time.

[5] If the particular PIE holding the controlling interest in Pubco is determined to be the UPE, note that this would not be the end of the matter. As indicated, many cases will involve layers and tiers of companies and trusts above the PIE. See infra, "Ability of taxpayers to comply – simplification benefits without tax base erosion," at page 6.

are presumably not requiring consolidated financial statements because they are not extending credit to the operations of the Pubco. If the lender was in fact extending credit to the Pubco, it would presumably have required the controlling PIE to consolidate the Pubco line-by-line, in which case the PIE would (and should in policy terms) be the UPE.

In our experience, although some of the tax planning of the Pubco may be relevant to the controlling PIE (e.g., safe income planning), any BEPS-style tax planning by the Pubco at which Pillar Two is aimed is separate and distinct from any BEPS-style planning the PIEs may engage in with respect to investments other than the Pubco. In other words, it would be inappropriate, including from a corporate governance perspective, to integrate the BEPS-style tax planning of the Pubco and the controlling PIE. The fact that consolidated financial statements are not prepared is evidence that stakeholders are not evaluating integrated/consolidated effective tax rates (ETRs) at the PIE level. As such, in any particular case, it would be inappropriate in tax policy terms to combine the jurisdictional results of both the Pubco and the PIE's other investments as that would produce arbitrary jurisdictional ETRs that may be disconnected from reality (and, in some cases, undermine the purpose of Pillar Two).

Consolidated financial statements – interpretation and application

The crux of the issue lies in the interpretation of "consolidated financial statements" (CFS) and the definitions of the terms used therein (subsection 4(1) of the GMTA[6]). Prior to developments indicated at the outset of this letter, we found that the definition of CFS in the GMTA was consistent with the definition in section 10.1 of the OECD Model Rules (and related definitions), Commentary, and Administrative Guidance (February 1, 2023)) as well as being easier to read and clearer. A more fulsome analysis of the OECD Model Rules, Commentary, and Administrative Guidance is set out in the Appendix 1; however, this letter will reference the provisions of the GMTA.

Starting with the simple case where the sole purpose of the PIE is to hold the controlling interest (commercial, not as defined in subsection 4(1)) in Pubco (as distinct from broader aspects of the factual context that are also relevant to this interpretive and policy analysis and to which we return below), we think that a PIE that controls a Pubco but does not have a controlling interest (as defined in subsection 4(1)) in such Pubco (because it does not consolidate the Pubco line-by-line) is not a UPE (as defined in subsection 12(1)). Paragraph (d) in the definition of CFS contains the deemed consolidation test; however, provided the PIE prepares financial statements using an acceptable financial accounting standard[7] which does not require consolidation of controlled investments, paragraph (d) is satisfied, with the result that the PIE is not the UPE. Even if the PIE had a controlling interest in some investments (as defined in subsection 4(1)) and as such was a UPE, the financial statements of which would be governed by paragraph (a) of CFS, as ASPE is an acceptable financial accounting standard that does not require consolidation of subsidiaries, paragraph (a) would be satisfied as the PIE would not have a controlling interest (as defined) in Pubco, making Pubco the UPE of the Pubco Group. The PIE would be the UPE of its group (i.e., excluding Pubco).

Given the ambiguity of the scope of material competitive distortion, it is conceivable that paragraph (c) could govern the preparation of the PIE's financial statements. Although we do not think the lack of consolidation reflects a material competitive distortion, paragraph (c) only becomes engaged in cases where CFS are not prepared based on an acceptable financial accounting standard. As ASPE is an acceptable financial accounting standard that does not require consolidation, paragraph (c) has no role.

---

[6] Unless otherwise noted, all section references herein are to the GMTA.
[7] ASPE is an acceptable financial accounting standard as it forms part of Canadian generally accepted accounting principles (GAAP) (paragraph 4(1)(a)).

The result of this interpretation – that the PIE's financial statements in this circumstance qualify as CFS as defined in subsection 4(1) – may seem counter-intuitive. However, we do not see the choice not to consolidate as manipulative or unnatural. In fact, we see it as a simplification-based extension of investment company (entity) accounting, which may be available to some PIEs, although few PIEs are applying such rules today.[8] The fact that ASPE does not require an entity to report the financial position and results of operations of what would otherwise be a controlling interest in its CFS raises the question whether the result frustrates the deemed consolidation test. If there were an avoidance transaction, it is conceivable the general anti-avoidance rule (GAAR) in section 52 could apply. However, in this regard, we think it is clear that the OECD has placed (for the time being at least) a high degree of trust (confidence) in the accounting standard setters in the listed countries. Moreover, ASPE is a general purpose generally accepted accounting principle (GAAP) – not used solely for tax purposes – that produces meaningful and useful financial statement information in the circumstances. There is no manipulation of accounting principles involved in this factual context. Indeed, the accounting practices at issue are longstanding and evidently not motivated by Pillar Two.

Purpose and policy

Combining unconnected publicly and privately owned businesses

Not only do we think this interpretation and result is aligned with the text and context of the Pillar Two rules, but we also think the conclusion that the PIE is not the UPE of the Pubco's multinational enterprise (MNE) Group aligns with the purpose of the Pillar Two rules and produces more appropriate outcomes from a policy perspective. If the Pillar Two rules were to require consolidation at a higher level, businesses which are completely unconnected (i.e., other investments of the PIE over which Pubco has no interest – none of ownership, control, influence, or accountability to shareholders) would be included in a single MNE Group for the purposes of the Pillar Two rules. This would affect jurisdictional ETR calculations, sometimes benefiting the Pubco Group (potentially to the detriment of the PIE) and sometimes benefiting the PIE (potentially to the detriment of the Pubco Group). For example, if the Pubco Group has a high-tax constituent entity (CE) in country Z, the PIE has a low-tax CE in country Z, and the PIE is the UPE for Pillar Two purposes, there may be no top-up tax (TUT) in respect of country Z due to averaging, whereas there may have been a TUT in country Z if the PIE was the UPE of its own group and in-scope of Pillar Two. In this case, the non-controlling Pubco shareholders have benefited the PIE. This enrichment comes at no cost to Pubco, unless the jurisdictional ETR falls below the 15% minimum rate, at which point including the PIE's CE in country Z in the UPE Group is to the detriment of Pubco (the extent to which depends on the relative Global Anti-Base Erosion (GloBE) income in the CEs in country Z). The opposite case can also occur. The point is that either outcome for Pillar Two purposes is arbitrary and inappropriate insofar as the businesses are otherwise unconnected from a business and tax planning perspective (for example, whether conducting ordinary business operations within a high-tax jurisdiction or availing themselves of a preferential tax regime in the same jurisdiction).

We understand that the Pillar Two rules explicitly contemplate jurisdictional tax rate blending across all local entities in the UPE Group with limited exceptions.[9] The stated reasons for this are: i) to avoid system integrity risks from shifting income and taxes between CEs located in the same jurisdiction, ii) to avoid potential distortions caused by particular features of domestic tax systems (such as loss-surrender and tax consolidation mechanisms), and iii) simplify the mechanic for the attribution and allocation of top-up taxes.[10]

[8] Accounting Guideline (AcG) 18 sets out the criteria which must be met for a company to qualify as an investment company, the consequence of which is that investments are not permitted to be consolidated but rather are carried at their fair market value with annual gains and losses recognized in income. See Appendix 1 for more details on AcG-18 and IFRS 10, the corresponding financial accounting standard applicable to public companies in Canada.
[9] The exceptions for certain investment entities, minority-owned CEs, and stateless entities are limited and not at issue here.
[10] Chapter 5, paragraph 4 of the OECD Commentary (2022).

In general, these rationales for jurisdictional ETR blending presume some level of common control, interaction, and coordination over the activities within a jurisdiction. In our experience, although ultimate common control exists, interaction and coordination, will rarely (if ever) exist (for corporate governance reasons) between the Pubco's activities in the aforementioned country Z and the activities of a CE of the PIE's group in country Z.[11]

Distinguishing public company conglomerates from PIEs

We distinguish PIEs from a public company conglomerate that is managed and controlled as one group and consolidates CEs on a line-by-line basis. Even in cases of public company conglomerates that consolidate controlled investments, it is conceivable that the conglomerate's underlying investments are managed on a separate and distinct basis and not integrated in any way. Nevertheless, as all of the relevant businesses would be owned by the Pubco, the businesses would be more actively (and consistently or evenly) managed and controlled at the Pubco level than in the case of a PIE holding investments outside of the Pubco group. Thus, if the public company conglomerate consolidates controlled investments, it is not unreasonable that it be treated differently than the PIE (i.e., that the public company conglomerate is the UPE for Pillar Two purposes).

A more difficult case – from a neutrality perspective – is a public company conglomerate that owns a controlling stake in another Pubco.[12] This situation may be more akin to the PIE context in that it is more likely that the contemplated control, interaction, and coordination – between the activities of a CE of each of the public company conglomerate and the other Pubco in the same jurisdiction – does not exist. That said, we understand and accept that the Pillar Two system has adopted prescribed accounting standards to govern group determinations. Thus, a public company conglomerate that consolidates controlled investments (including another Pubco) would be the UPE for Pillar Two purposes.

As indicated above, the factual contexts in these public company cases may differ only subtly from the PIE context, giving rise to equally fine policy distinctions. However, the public company conglomerate can be distinguished from the PIE in that it has other (external) stakeholders for whom important (and distinguishing) governance obligations exist. In addition, the public company conglomerate is more likely to have the information and resources available to comply with the Pillar Two system compared to the PIE which is more passive in its activities, has fewer stakeholders, and less capacity to comply (see below "Ability of taxpayers to comply – simplification benefits without tax base erosion").

Global consistency

We recognize that not all jurisdictions that have agreed to Pillar Two may have an ASPE equivalent. Thus, in some jurisdictions, there may be no acceptable financial accounting standard permitting non-consolidation and Pillar Two outcomes may vary across jurisdictions as a result. We understand that it is highly desirable (necessary) that Pillar Two systems across jurisdictions conform to common rules. However, there will necessarily be some disparate treatment across jurisdictions given the heavy (fundamental) reliance of the system on acceptable financial accounting standards and the possibility of different interpretations. We also think the Pillar Two tax raised in cases that are the subject of this letter will be the same in most (if not all)

[11] In this regard, we note that of the many examples accompanying the OECD Commentary (2022), illustrating the application of the top-down approach of the income inclusion rule (IIR) and the offset mechanism in the context of UPEs, intermediate parent entities and partially-owned parent entities, none involve a case where a CE of a UPE in a jurisdiction was combined with a CE of a POPE in the same jurisdiction nor are there examples illustrating jurisdictional ETR blending in such cases. Thus, it is unclear whether this situation was contemplated.
[12] See infra, "Tax avoidance concerns in the context of investments in private companies," at page 7, for commentary on neutrality and tax avoidance concerns.

cases. We acknowledge that the amount of tax raised may differ in some cases – when unrelated businesses in a PIE's public and private groups are combined to determine jurisdictional ETRs. However, as indicated above, we think those outcomes (for better or worse) would be inappropriate in policy terms. Thus, we do not see the proposed interpretation causing meaningful inconsistencies in the context of the Pillar Two system.

Ability of taxpayers to comply – simplification benefits without tax base erosion

The relationships between the family offices representing controlling shareholders of Pubcos and the Pubcos themselves vary in that some work together more closely than others. However, in general, they are separate – tax personnel at the Pubcos have limited visibility on the broader tax work at the family office level and tax personnel at the family office level have limited visibility on the tax planning of the Pubcos and their financial accounting. This reflects both sound corporate governance and capacity limitations. If the PIEs had the obligation to comply with Pillar Two, this would impose a substantial burden on them as there is limited visibility of the underlying domestic and foreign entities of the Pubcos at the family office level. As indicated above, there is typically no consolidation for financial statement purposes and therefore none of the familiarity and knowledge that comes from the consolidation process exists at the family office level.

If a particular PIE were determined to be the UPE, note that further work would be required to determine whether the actual UPE were another entity above – with the PIE likely becoming an intermediate parent entity (IPE) (or, rarely, a partially-owned parent entity or POPE). As a result of the division of ownership among family members and co-investors/private partners, each of the affected cases would involve (require) significant accounting and advisory support to determine the UPE. For most of the affected groups, no such advisory relationships currently exist as the stakeholders (mostly family members, trustees of family trusts, and the Canada Revenue Agency) are satisfied with the basic financial information currently provided. See Appendix 1 for some indication of the complex accounting determinations (giving rise to new and substantive tax reporting requirements) that would now be imposed on PIEs for no reason other than Pillar Two.

Aside from the significant (disruptive) human resource practicalities and compliance costs, if the PIEs were UPEs, this would unnecessarily increase the number of POPEs. The POPE concept mitigates a Pillar Two tax base erosion risk by ensuring that Pillar Two TUT reflects all the direct and indirect economic ownership in low tax jurisdictions. However, if the PIEs that are the subject of this letter are not UPEs – for the reasons set out herein – then the Pubcos would no longer be POPEs and the appropriate amount of TUT would still be paid. If the PIEs are UPEs, TUT must be considered at two levels (i.e., the UPE and the POPE) with needless complexity (and new coordination needs) arising as the offset mechanism (item B in subsection 15(1)) applies to the same effect as if the Pubco was the UPE (and not a POPE). As the PIEs contemplated in this letter do not own, directly or indirectly, interests in CEs of the Pubco other than through the Pubco, the interpretation set out herein simplifies compliance substantially without affecting tax revenues (subject to the point above regarding inappropriate outcomes from combining jurisdictional ETR calculations).

Avoid inappropriate interaction with system of integration

If the PIEs contemplated in this letter were the UPEs for Pillar Two purposes, the investment income earned in the PIEs (interest, dividends, capital gains) could become in-scope revenues for Pillar Two purposes if the revenues of the Pubco increased the revenues of the UPE beyond the €750 million threshold (subject to allowances for "excluded dividends" and "excluded equity gain or loss" as defined in subsection 4(1)). At the same time, refundable taxes applicable to Canadian-controlled private corporations (CCPCs) in Canada are likely a "disqualified refundable imputation tax" as defined in subsection 4(1) – on the basis that the refund is received by the CE and not by the shareholder on a dividend or similar distribution – and therefore excluded from “covered taxes” by virtue of “excluded taxes” in subsections 23(1) and (2), respectively. To the extent a PIE’s Group may also realize substantial capital gains from a “portfolio holding” as defined in subsection 4(1) – taxed at approximately 8% to 12% ignoring refundable taxes and depending on the province – such PIE Group may have an ETR below the 15% minimum rate. In such cases, the QDMTT could impose additional tax on income that is subject to Canada’s refundable tax system that operates to integrate corporate and individual taxation. In other words, income that is, both when realized at the corporate level and on an integrated basis after distribution to shareholders, subject to tax well in excess of 15% could now be subject to the GMT under Pillar Two.

We recognize that this issue applies primarily to large corporate groups and Canada’s wealthiest individuals and families. However, the overlapping layers of taxation could result in an extraordinarily high burden of taxation on investment income – an incidental consequence of the Pillar Two system that we expect was unintended. The taxation of investment income in Canada should be governed by corporate and personal tax rates and the system of integration. Moreover, recent changes– for example, substantive CCPCs, reduced relevant tax factors for foreign accrual property income (FAPI) earned through CCPCs, and the alternative minimum tax proposals – would seem to adequately address concerns with the taxation of investment income of wealthy Canadians. If the QDMTT were to become another potential layer of taxation to navigate, it would likely produce non-neutral and arbitrary outcomes as the mix of income earned by CCPCs that would be excluded for Pillar Two purposes (or not) will likely vary widely across taxpayers. The very rough approach underlying the global minimum tax agreement reached by OECD G20 Inclusive Framework – rooted in accounting principles governing income measurement and corporate groups – is appropriate in the MNE context and given the modest 15% rate; however, it ought not to be impacting Canada’s system of taxation of investment income of CCPCs. We could recommend amendments to the system of refundable tax – such that the relevant refundable taxes are “qualified imputation tax”; however, we think the interpretation set out herein achieves the appropriate result without the need to re-engineer the current system.

We acknowledge that some PIEs may qualify for investment company treatment under AcG-18 (or take steps to so qualify) and that restructurings may be undertaken to either break control to avoid consolidation under a deemed consolidation rule or separate investment income from indirect interests in global business income to avoid the outcomes above. However, such restructurings should be expected to be complex given the nature of family relationships, diverse interests in family property, and the complexity and uncertainty of applying the Pillar Two rules which are the subject of this letter.

Tax avoidance concerns in the context of investments in private companies

If ASPE were to be adopted indiscriminately, it could create significant tax avoidance opportunities for private companies. For example, if a private company were to restructure (divide) the ownership of a MNE group (made up of one business) into say four Canadian resident holding or operating companies, such that each was below the €750 million revenue threshold, the option under ASPE not to consolidate could result in inappropriate tax avoidance. Moreover, there may also be pre-existing situations where applications of ASPE may result in inappropriate tax avoidance. For example, some large private (family) businesses that would otherwise be in-scope of Pillar Two – particularly those with little or no debt owing to third parties or other external stakeholders requiring the preparation of consolidated financial statements – may escape the Pillar Two system if consolidated financial statements are not prepared. Similarly, a private Canadian corporation could own a commercially controlling interest in an otherwise stateless (foreign) entity and choose not to consolidate it.

In addition, if a PIE held two otherwise separate global business investments and yet integrated and coordinated BEPS-style tax planning across the platforms, then we think Pillar Two TUT should be imposed on a group-wide basis in such a circumstance based on the discussion above regarding the presence of interaction and coordination amongst CEs in the context of jurisdictional ETR calculations.

In general, we think these cases, as a factual matter, rarely exist today and there are normal commercial pressures guarding against an increase in these cases, including:

1. In our experience, it is unusual for a business of the scale necessary to be in-scope of Pillar Two to not have some debt or external stakeholder requiring audited consolidated financial statements at the appropriate UPE level. We also consider it unlikely that say banks or other external stakeholders would readily allow a global (otherwise in-scope) business headquartered in Canada to separate its business elements into separate legal entities without also requiring a consolidation at the appropriate parent company (UPE) level.

2. In our experience, it is also uncommon for private entities/family offices to integrate or commingle tax planning across companies and groups that are not otherwise integrated from a business perspective as this would complicate exits from any of the platform companies.

That said, we recognize that the option to not consolidate under ASPE is likely to incentivize taxpayers to adopt ASPE, maintain their existing adoption of ASPE, or put themselves in a position where they could adopt ASPE, and seek to exploit these potential benefits. In light of these valid tax avoidance concerns, a specific anti-avoidance rule (SAAR) could be introduced that would apply to require consolidation if the principal purpose or reason for adopting ASPE is to reduce TUT under Pillar Two. In addition, in the case of controlling ownership positions in private entities, the SAAR could include a rebuttable presumption that the principal purpose or reason for adopting ASPE is to reduce TUT under Pillar Two.

Under this SAAR approach, we think PIEs that are the focus of this letter would not be subject to the SAAR and would not have to meet the rebuttable presumption. If the PIE owning a private Opco Group operated in the same fashion as the PIE owning a controlling interest in a Pubco, the PIE could adopt ASPE, rebut the presumption, and achieve a neutral outcome in relation to the case of the controlling interest in Pubco. Although the PIE owning a controlling interest in Pubco would not be required to meet the rebuttable presumption, such PIE would have to meet the rebuttable presumption for other private investments.

We think the SAAR approach would i) result in the appropriate amount of revenue raised, ii) achieve neutral outcomes across public and private companies, iii) limit the role of the Pillar Two system in the taxation of investment income in Canada to very large investment businesses, and iv) minimize (needless) compliance and administrative burden.

As indicated at the outset, we recognize that a SAAR is unnecessary based on the intended meaning of CFS and Canada's intentions in this regard are consistent with the OECD's. That said, through work at the OECD, this could be introduced as a backstop SAAR of general application (i.e., not singling out ASPE in Canada) which could be adopted by Canada and as such consistent with the globally agreed upon Pillar Two system.

Country-by-country reporting redundancies

The definition of a UPE for the purposes of the Pillar Two Rules is distinguishable from the definition in section 233.8 of the *Income Tax Act* (Canada) that applies to the determination of a UPE in the context of country-by-country reporting (CbC). In the case of CbC reporting, UPE means a constituent entity of a MNE group that meets certain conditions, including the hypothetical condition where the constituent entity "*would be so required* [to consolidate] if its equity interests were traded on a public securities exchange in its jurisdiction of residence." This deemed hypothetical can result in the private entity being the UPE in cases contemplated in this letter as it effectively precludes ASPE. This deemed hypothetical should be contrasted with the more prescriptive Pillar Two rules with respect to identifying the UPE. Therefore, the identification of a UPE for CbC reporting purposes is not determinative when identifying a UPE under the Pillar Two rules.

A further consequence of the above – which is compatible with the draft provisions of the GMTA – is that the Pubcos may become required to prepare qualified financial statements to comply with Pillar Two at that level even though any such Pubco may not have been responsible for CbC reporting in the past. Although we think the preparation of CbC reports at the Pubco level is necessary and compatible with the Pillar Two regime, we recognize that may result in overlapping or redundant CbC reporting as the Pubco would file at its level for Pillar Two purposes while the private entity would continue to include the Pubco's CbC reporting in its CbC reporting. Although reporting at multiple levels for two different purposes could be justified given the two different regimes, we recommend a coordinating or priority rule that turns off any requirement for the private entity to report CbC information to the extent such information has already been reported by a related Canadian corporation under the GMTA. Just as we consider the application of Pillar Two at the Pubco level to produce more appropriate outcomes in light of the purpose of Pillar Two, we also think the separation of CbC information between the Pubco and the private entities would produce higher quality information for the Canada Revenue Agency's risk assessment purpose.

Whether or not the government wishes to amend the *Income Tax Act* as put forward here, it is recommended that the GMTA be amended to provide for filing with CRA the CbC reports required under Pillar Two – either on an automatic or elective basis.

* * * * * * *

We hope that our specific comments are helpful in your consideration of the GMTA. We would be pleased to meet with you or other officials to discuss our submission as Deloitte is committed to making a significant contribution to help shape Canada's tax policy and its application to the future of our country.

We consent to the disclosure of our comments under the *Access to Information Act* and have made a copy of our submission available on our website at www.deloitte.ca.

Yours very truly,

Deloitte, LLP

Rob Jeffery, CPA, CA
National Tax Policy Leader
Deloitte LLP

Jonathan Lazure
National Pillar Two Leader
Deloitte LLP

Appendix 1

Model Rules, Commentary, and Administrative Guidance

As a starting point, the Pillar Two rules define a **Parent Entity** in Article 10.1 as a UPE that is not an Excluded Entity, an Intermediate Parent Entity, or a Partially-Owned Parent Entity.

Article 1.4 of the Pillar Two rules defines a **UPE** as either:

(a) an Entity that:
   a. owns directly or indirectly a Controlling Interest in any other Entity, and
   b. is not owned, with a Controlling Interest, directly or indirectly by another Entity, or

(b) [in respect of a Permanent Establishment] the Main Entity of a Group that is within Article 1.2.3.

The concept of Controlling Interest is therefore critical to the determination of the UPE of a MNE Group. Article 10.1 defines a **Controlling Interest** as an Ownership Interest in an Entity such that the interest holder:

(a) *is required to* consolidate the assets, liabilities, income, expenses and cash flows of the Entity on a line-by-line basis in accordance with an Acceptable Financial Accounting Standard; or
(b) *would have been required to* consolidate the assets, liabilities, income, expenses and cash flows of the Entity on a line-by-line basis if the interest holder had prepared Consolidated Financial Statements. (Emphasis added.)

Under the Pillar Two rules, in Article 10.1, an **Ownership Interest** is defined as "any equity interest that carries rights to the profits, capital or reserves [the "**Economic Rights**"] of an Entity, including the profits, capital or reserves on a Main Entity's Permanent Establishment(s)." This definition does not include any reference to rights to control the selection of members of the Board of directors, nor the rights to residuals.

Given the definitions of a Controlling Interest and an Ownership Interest, the Pillar Two rules therefore rely on the accounting principles applicable in the Consolidated Financial Statements of an Entity or, by virtue of paragraph (b) of the definition of a Controlling Interest, require consideration of the accounting principles that would have applied had Consolidated Financial Statements been prepared. Article 10.1 further defines **Consolidated Financial Statements** to mean:

(a) the financial statements prepared by an Entity in accordance with an Acceptable Financial Accounting Standard, in which the assets, liabilities, income, expenses and cash flows of that Entity and the Entities in which it has a Controlling Interest are presented as those of a single economic unit;
(b) where an Entity meets the definition of a Group under Article 1.2.3, the financial statements of the Entity that are prepared in accordance with an Acceptable Financial Accounting Standard;
(c) where the Ultimate Parent Entity has financial statements described in paragraph (a) or (b) that are not prepared in accordance with an Acceptable Financial Accounting Standard, the financial statements are those that have been prepared subject to adjustments to prevent any Material Competitive Distortions; and
(d) where the Ultimate Parent Entity does not prepare financial statements described in the paragraphs above, the Consolidated Financial Statements of the Ultimate Parent Entity are those that would have been prepared if such Entity were required to prepare such statements in accordance with an Authorised Financial Accounting Standard that is either an Acceptable Financial Accounting Standard

> or another financial accounting standard that is adjusted to prevent any Material Competitive Distortions.

Article 10.1 defines **Material Competitive Distortion** as follows:

> **Material Competitive Distortion** in respect of the application of a specific principle or procedure under a set of generally accepted accounting principles means an application that results in an aggregate variation greater than EUR 75 million in a Fiscal Year as compared to the amount that would have been determined by applying the corresponding [International Financial Reporting Standards (IFRS)] principle or procedure. Where the application of a specific principle or procedure results in a Material Competitive Distortion, the accounting treatment of any item or transaction subject to that principle or procedure must be adjusted to conform to the treatment required for the item or transaction under IFRS in accordance with any Agreed Administrative Guidance.

There are two definitions of financial accounting standards which are referred to in the Consolidated Financial Statements definition above, which are both defined in Article 10.1:

- **Authorized Financial Accounting Standard** is defined as, in respect of an Entity, a set of generally accepted accounting principles (**GAAP**) permitted by the body with legal authority in the Entity's jurisdiction to prescribe, establish, or accept accounting standards for financial reporting purposes. In the Canadian context, this means both IFRS and ASPE should be considered Authorized Financial Accounting Standards for Entities based in Canada since they are included in the CPA Canada Handbook.

- **Acceptable Financial Accounting Standard** is defined as IFRS and the GAAP of a list of 17 specific countries or unions, including Canada. This means both IFRS and ASPE should be considered Acceptable Financial Accounting Standards.

Since both IFRS and ASPE should meet the definitions of both Authorized and Acceptable Financial Accounting Standards, consolidated financial statements prepared in accordance with either accounting standard should meet the requirements of paragraph (a) of the definition of Consolidated Financial Statements. ASPE, specifically, is a comprehensive set of accounting practices included in Part II of the CPA Canada Handbook and is the recognized GAAP in Canada for private enterprises, rather than simply a framework for tax or some other special purpose.

In determining the UPE, where an Entity that may be the UPE does not otherwise prepare Consolidated Financial Statements, paragraph (d) of the definition of Consolidated Financial Statements deems Consolidated Financial Statements to be those which *would have been* prepared in accordance with an Authorized Financial Accounting Standard and paragraph (b) of the definition of Controlling Interest refers to whether consolidation on a line-by-line basis would have been required if Consolidated Financial Statements had been prepared. Effectively, the Pillar Two rules consist of a "deemed consolidation test" for the purposes of identifying and determining the UPE where Consolidated Financial Statements are not otherwise prepared.

For the purposes of this deemed consolidation test, the Administrative Guidance to the Pillar Two rules clarifies at paragraphs 10 and 11 of Article 1.2 that the Entity may select from any of the available Authorized Financial Accounting Standards applicable in its jurisdiction. The Administrative Guidance, at paragraph 10 of Article 1.2, also indicates that the deemed consolidation tests contained in the Controlling Interest and Consolidated Financial Statements definitions do not require an Entity to consolidate on a line-by-line basis where the Authorized Financial Accounting Standard does not require such consolidation, referencing fair value accounting by an investment entity as an example where IFRS does not require line-by-line consolidation. Similarly, the Administrative Guidance further indicates that the deemed consolidation test does not modify the standards or alter the outcomes that are provided for under the relevant accounting standard and does not treat a holder of an Ownership Interest as holding a Controlling Interest in an Entity where the relevant Authorized Financial Accounting Standard would not require consolidation of the assets, liabilities, income, expenses, and cash flows of that Entity on a line-by-line basis.

The Administrative Guidance also set out four examples which illustrated the application of these rules and commentary. However, none of the examples involved a private investment entity in a jurisdiction like Canada where ASPE exists as an acceptable financial accounting standard.

Accounting for Investment Entities: A Comparison of AcG-18 to IFRS 10

IFRS 10 requires that an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.[13] In a similar manner, ASPE requires an investment company to measure its investments at fair value and present them as such in its financial statements.[14]

AcG-18, Investment companies, specifically under AcG-18.2, provides that ASPE requires that an investment company's primary business activity consists of buying, holding and selling investments.[15] Fair values and changes in fair values of investments held by investment companies are as important to investors as the investment income earned. Transactions to buy and sell shares in an investment company are typically based on the fair value of the investment company's investments.[16] Accordingly, AcG-18 requires that entities which meet the five requirements to be an investment company, discussed in more detail below, present their investments at fair value and present changes in the fair value of investments in net income in the period in which the change arises. The presentation of such information is to provide more useful information to the users of the financial statements than consolidated financial statements prepared in accordance with ASPE 1601 Consolidated financial statements. Additionally, ASPE 1591 Subsidiaries and ASPE 3051 Investments also contain language which defers to AcG-18 if the requirements of an investment company are met. For the same reasons, IFRS 10 requires investment entities to measure investments at fair value. Therefore, both IFRS and ASPE require investment entities to present their investments at fair value if they meet the respective requirements. For greater certainty, such requirements are not an accounting policy choice.

The requirements to be an investment entity or investment company are similar under the two financial accounting standards, though they are not identical, as presented below.

IFRS identifies an investment entity as an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

[13] See IFRS 10.31.
[14] See AcG-18.5.
[15] See AcG-18.2.
[16] Ibid.

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.[17]

Appendix B to IFRS 10 includes additional guidance for determining whether an entity is an investment entity. This guidance is lengthy, but the main points are:

(a) the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest or rental income), or both;[18]
(b) an investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments, and shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments;[19]
(c) an entity is not investing solely for capital appreciation, investment income, or both, if the entity or another member of the group containing the entity (i.e., the group that is controlled by the investment entity's ultimate parent) obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties that are not related to the investee;[20]
(d) an investment entity measures and evaluates the performance of substantially all of its investments on a fair value basis, because using fair value results in more relevant information than, for example, consolidating its subsidiaries or using the equity method for its interests in associates or joint ventures;[21] and
(e) an investment entity displays the typical characteristics of one, though the absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity but indicates that additional judgement is required in determining whether the entity is an investment entity

   i. more than one investment,
   ii. more than one investor,
   iii. unrelated investors, and
   iv. ownership interests.[22]

ASPE identifies an investment company as a separate legal entity whose primary business activity for the period is investing,[23] and requires all of the following to apply for an enterprise's primary business activity to be considered investing:

(a) the enterprise's expressed business purpose is to be an investment company that holds investments for current income, capital appreciation, or both;
(b) the enterprise has no substantive activities other than its investment activities and no significant assets or liabilities other than those related to its investment activities, except for operating activities related to services provided to investment companies;

---

[17] See IFRS 10.27.
[18] See IFRS 10.B85B.
[19] See IFRS 10.B85F.
[20] See IFRS 10.B85I.
[21] See IFRS 10.B85K.
[22] See IFRS 10.B85N – B85W.
[23] See AcG-18.8.

(c) the enterprise does not obtain, or have the objective of obtaining, benefits from its investments that are unavailable to unrelated non-investor enterprises and that are not normal benefits attributable to an ownership interest (such as dividends). Such benefits might include, for example:

   i. access to processes, intangible assets or technology of the investee;
   ii. guarantees provided by an investee to benefit the investor;
   iii. or other transactions that are not at fair value;

(d) the enterprise or its affiliates are not involved in the day-to-day management of investees, affiliates of investees, or other investment assets. However, that requirement may be met if management of the enterprise or its affiliates is represented on the boards of directors of investees or affiliates of investees, or provides limited assistance to management of investees or affiliates of investees for a short period; and

(e) for each investment, the enterprise has an exit strategy that involves the transfer of the enterprise's ownership interest to unrelated third parties. An exit strategy includes methods of exiting the investment and the time when this is expected to occur. For example, this might be expressed as a time period or when certain conditions or targets have been met.[24]

ASPE is more prescriptive in identifying an investment company compared to the definition prescribed under IFRS. Under IFRS, judgement must be exercised to determine whether an entity is an investment entity or not. The exercise of judgement in the case of IFRS is, however, similar to other differences between the standards, with ASPE generally being more prescriptive than IFRS as a whole. Notwithstanding these differences, both IFRS and ASPE try to identify characteristics unique to entities whose financial statement users would derive more useful information from the fair value of investments as compared to consolidated financial statements.

[24] See AcG-18.9.