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Canadian Tax & Legal Alert

What does Pillar One mean for corporate Canada?

January 14, 2021

In October 2020, the Organisation for Economic Co-operation and Development (OECD) released the report *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*[1] (Blueprint).

Whilst the project was originally focused on certain types of digital business, it has evolved and is likely to impact any consumer facing business (CFB) as well as businesses that provide automated digital services (ADS).

While much work is yet to be done, and there are many areas where decisions on specific rates, exemptions, etc., must be taken, the Blueprint does provide an overview of an ambitious new realm. At over 200 pages, the Blueprint sets out the OECD's current thinking in regard to a new international tax model – one that would take a step away from two traditional and fundamental international tax principles.

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[1] Available online on the OEDC website.

- First, under the proposals, multinationals may become subject to tax in a jurisdiction without any physical nexus – a step away from the traditional concept of "permanent establishment".
- Second, for multinationals that are in scope, a portion of their global income would be allocated on a formulary basis without regard to the arm's length principle.

The OECD's stated objective is to resolve the outstanding technical matters and reach a consensus agreement by mid-2021, with implementation of the new approach by 2024. While this timeline seems ambitious, it needs to be kept in mind that, in the absence of action on Pillar One, more and more countries (including Canada) are moving towards adoption of a unilateral solution – in particular, the use of Digital Service Taxes.

The desire to avoid such unilateral measures, and the impact of retaliatory trade measures, seems to be creating the political momentum to keep the project moving forward. Under the proposed new paradigm, companies will need to determine whether they are potentially in scope based on size; whether they are potentially in scope based on the nature of their business; and whether they are in scope based on the level of profitability. Further, companies that are above (or close to) the size threshold will likely have some significant new compliance obligations to substantiate and document whether they are in scope or not, and the basis for establishing the impact of the new regime.

But what does it mean for the Canadian business community? While there may be a small number of Canadian companies that will have a material increase in their overall level of taxation as a result of the new regime, many more will at a minimum have some compliance obligations. Tax Directors will likely start to face questions regarding the impact of the new regime on their company's effective tax rate and tax department budget.

The following provides an indication of the potential impact for Canadian businesses.

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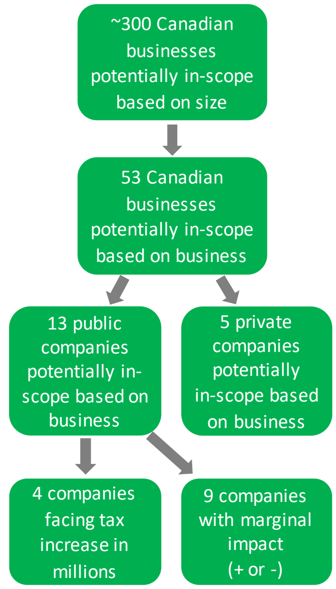
Tests for inclusion in new regime	Observations
Size test	
• It is likely that the new regime would only apply to companies with global revenues over a threshold. • While the OECD has not come to an agreement on the revenue threshold, it looks like the Euro 750 million level used for country-by-country reporting is getting serious consideration.	• While the size threshold has not been agreed, it would appear based on recent surveys of the Canadian business environment that around 300 Canadian businesses could be at (or close to) the size threshold.
Business activity tests	
• The new regime applies to ADS and CFB. • Many businesses are specifically exempted.	• It would appear that considerable work is needed to reach a consensus on what types of businesses are in scope. Based on current indications in the Blueprint, 53 Canadian businesses could be in scope. • From a compliance perspective, it is unclear what reporting will be required where businesses are involved in both in-scope and out-of-scope activities.
Profitability tests	
• Potentially in-scope businesses will only be subject to new tax obligations if global profit before tax exceeds an agreed threshold.	• Further work is needed to reach a consensus on: – The minimum profit threshold. – The portion of excess profits that would be allocated to market jurisdictions. – Mechanisms to allow for loss carryovers. • Based on current indications in the Blueprint, 13 Canadian public companies and 5 Canadian private companies could be in-scope.
Impact on affected business	**Observations**
• A portion of "residual" income is allocated to market jurisdictions. • Corresponding exclusion from existing entity(ies).	• From a compliance perspective, extensive systems upgrades may be needed to track revenue by market. • Further work is needed to reach a consensus on mechanism to avoid double tax (exemption vs. credit; entity(ies) to be impacted; etc.). – Depending on mechanism, it is unclear whether companies will only face an increase in global tax, or if a decrease is possible.



For a small number of companies based in Canada, Pillar One is likely to result in a meaningful increase in their global tax burden. For many others, the tax impact may be low, but the compliance burden may be significant.

How can Deloitte help you?

Deloitte’s Transfer Pricing professionals can help you understand how this new regime may affect your business.

If you have any questions on any of the above, please reach out to your Deloitte representative or any of the individuals noted on this alert.

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