Osgoode Hall Law School of York University
Osgoode Digital Commons

Articles & Book Chapters | Faculty Scholarship

2023

Canadian QDMTT Challenges

Jinyan Li

Angelo Nikolakakis

Jean-Pierre Vidal

Source Publication:
Canadian Tax Journal, forthcoming 2023

Follow this and additional works at: https://digitalcommons.osgoode.yorku.ca/scholarly_works

Part of the Taxation-Transnational Commons, Tax Law Commons, and the Transnational Law Commons

Canadian QDMTT Challenges

Jinyan Li
Angelo Nikolakakis
Jean-Pierre Vidal

***Jinyan Li,** Professor and Co-director of LLM Tax Programs, Osgoode Hall Law School, York University; **Angelo Nikolakakis,** EY Law LLP (affiliated with Ernst & Young LLP in Canada); **Jean-Pierre Vidal,** Professor, HEC Montreal

Précis

Personne ne croit que le Canada est un paradis fiscal. Il n'en reste pas moins que le taux effectif d'imposition de certaines entités pourrait y être inférieur à 15%. Si rien n'est fait, le Pilier Deux pourrait donc s'y appliquer et des impôts qui reviennent naturellement au Canada pourraient finir entre des mains étrangères. Il faut donc trouver une solution et la plus évidente est celle d'adopter un qualified domestic minimum top up tax. D'autres solutions sont possibles, mais elles semblent moins attirantes. Le QDMTT présente quand même certains défis. Parmi ces défis, il faut compter le partage avec les provinces, la détermination de la priorité qu'il faut donner à certains impôts étrangers relatifs à un revenu canadien (c'est-à-dire, si ces impôts étrangers ont la priorité sur le QDMTT ou vice versa), l'estimation de certains impôts étrangers.

Abstract

Nobody believes that Canada is a tax haven. The fact remains that the effective tax rate of certain entities could be less than 15%. If nothing is done, Pillar Two could therefore apply and taxes that naturally accrue to Canada could end up in foreign hands. We must therefore find a solution and the most obvious is that of adopting a qualified domestic minimum top up tax. Other solutions are possible, but they seem less attractive. A QDMTT still presents some challenges. These challenges include sharing with the provinces, determining the priority to be given to certain foreign taxes relating to Canadian income (i.e., whether those foreign taxes take priority over the QDMTT or vice versa), estimating certain foreign taxes.

Key Words: Digitalisation of Economy; Pillar Two; Global Minimum Tax; IIR; UTPR; QDMTT; BEPS;

33 # I. INTRODUCTION

34 The adoption of a domestic minimum top-up tax (DMTT) is a potential policy response to the
35 introduction by other jurisdictions of a global minimum tax (GMT) on large multinational
36 enterprises (MNEs). It can be introduced as part of the process of implementing Pillar Two, or
37 more precisely the Global Anti-Base Erosion (GloBE) Rules[1] by transposing the OECD Model
38 Rules.[2] Pillar Two "is intended to ensure that the profits of large MNEs are subject to an
39 effective tax rate (ETR) of at least 15 per cent, regardless of where they are earned." [3] To achieve
40 this objective, Pillar Two relies on an unprecedent mechanism – permitting multiple countries to
41 charge a top-up tax in respect of the income earned in a particular low-tax country under an
42 Income Inclusion Rule (IIR) or Under-Taxed Payment (or Profit) rule (UTPR). [4] A low-tax country
43 has the option to introduce a DMTT to charge a top-up tax of its own to pre-empt other
44 countries from charging a top-up tax via the IIR or UTPR. However, the DMTT must be generally

---

[1] Despite the reference in the acronym GLoBE to "Anti-Base Erosion", it is important to understand that this regime is no longer focussed only on situations involving base erosion in the sense of the BEPS project. In addition, Pillar Two contemplates the possibility that jurisdictions could adopt a Subject to Tax Rule ("STTR") to impose increased withholding taxes, capped at 9% on certain payments to low-tax entities, such as interest and royalty payments. This measure is intended to allow developing countries to protect their tax base when out-bound payments are made to low-tax recipients. The Model Rules (infra note 2) do not specifically address the STTR. As far as Canada is directly concerned, the STTR is largely irrelevant as Canada's nominal corporate tax rate is above the threshold for triggering the STTR. Canada may, however, be indirectly concerned because foreign subsidiaries of Canadian MNEs may be exposed to a STTR.

[2] OECD, Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, (Paris: OECD, 2021) (the "Model Rules"); OECD, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), (Paris: OECD, 2022) (the "Commentary to the Model Rules"); and, OECD, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, (Paris: OECD, 2022) (the "Examples to the Model Rules").

[3] Canada, Department of Finance, 2022 Budget, A Plan to Grow Our Economy and Make Life More Affordable, April 7, 2022, 210. Canada, Department of Finance, 2022 Budget, Tax Measures: Supplementary information, April 7, 2022, 40-48, at 39.

[4] The IIR and UTPR no longer have the meaning as used in the original materials, such as the Pillar Two Blueprint – Tax Challenges Arising from Digitalisation –Report on Pillar Two Blueprint (October 14, 2020).. Under the Model Rules, supra note 2, the IIR is not about having an income inclusion rule, and the UTPR is not limited to payments made to Low-tax Entities by entities within a UTPR jurisdiction (and the acronym is no longer associated with the word "payments"). The allocation key for residual top-up tax liability among qualifying UTPR jurisdictions is based on their relative numbers of employees (not payroll costs) and tangible asset costs. It is this feature that could allow a subsidiary jurisdiction to impose a top-up tax on the profits earned in a separate subsidiary jurisdiction or in a parent jurisdiction. This is somewhat controversial. See Jinyan Li, "The Pillar 2 Undertaxed Payments Rule Departs from International Consensus and Tax Treaties," *Tax Notes Int'l,* Mar. 21, 2022, p. 1401; Casey Plunket, "What's in a Name? The Undertaxed Profits Rule," *Tax Notes Int'l*, Mar. 28, 2022, p. 1507; and Angelo Nikolakakis, "Bait and Switch — A Reply to Casey Plunket", *Tax Notes Int'l*, April 11, 2022, p. 169.

45 consistent with the GloBE rules in order to be recognized as a "qualified" DMTT (a "QDMTT") for
46 Pillar Two purposes.[5]

47 Canada has supported the development of Pillar Two and sought public input on the
48 implementation of the Model Rules that were written by the OECD under the auspices of the
49 G20/OECD Inclusive Framework on BEPS,[6] as well as public input on introducing a DMTT. The
50 Model Rules (and related Commentary) provide details on the IIR and UTPR but offer only
51 general guidance on the design of a QDMTT.

52 At the time of writing, it is unclear if Canada would be among the first movers on implementing
53 Pillar Two. It is beyond the scope of this paper to examine the pros and cons of Pillar Two, the
54 likelihood of implementation in Canada and other countries, or the moral, ethical or economic
55 implications of Pillar Two. We do not opine on whether Canada should do so but highlight the
56 importance of having a well-designed and workable QDMTT as part of the Pillar Two regime.

57 As a base-protection mechanism and a soak-up tax, a QDMTT helps preserve Canada's tax
58 jurisdiction over Canadian profits that are not otherwise taxed up to 15% ETR, largely owing to
59 tax preferences granted by the federal and/or provincial governments. By topping up Canadian
60 taxes to the minimum 15% ETR, the QDMTT will prevent another country from taxing Canadian
61 profits through its IIR or UTPR. The QDMTT will be consistent with Canada's overall policy
62 objective: "Through both pillars, the government remains committed to ensuring that those who
63 do business in Canada pay their fair share of taxes and there is a level playing field for Canadian
64 workers and businesses in the global economy."[7]

65 Without the QDMTT, implementing Pillar Two would likely erode Canada's ability to use tax
66 incentives as policy instruments or cause leaving money on the table, so to speak, for other
67 countries to tax through the IIR or UTPR. As much as Canada desires to be a global player in tax
68 reform, it presumably will do so with full regard to Canadian fiscal and economic interests.

69 Part II provides an overview of the QDMTT. Part III discusses the pros and cons of having a
70 QDMTT. Parts IV and V examine key design features of a Canadian QDMTT and explore the
71 significance of ordering as between the QDMTT and foreign taxes, such as foreign corporate
72 minimum taxes and taxes on controlled foreign corporation (CFC). Part VI concludes with some
73 cautionary notes about a QDMTT and its place in Pillar Two.

---

[5] However, a DMTT that is not a QDMTT could perhaps be characterized as a regular "Covered Tax", although as such it would not achieve the same defensive result because of the manner in which the effective tax rate is computed – before the so-called Substance-based Income Exclusion – as discussed below in greater detail (see infra note 8).

[6] Canada, Budget 2022, supra note 3. The consultation process was closed in July 2022.

[7] The Honourable Chrystia Freeland, Deputy Prime Minister and Minister of Finance, Fall Economic Statement 2022, at 39.

74 # II. QDMTT IN A NUTSHELL

75 ## A. What is a QDMTT?

76 A DMTT is a minimum tax charged under Canadian domestic law on low-taxed income of
77 Canadian Constituent Entities (CEs). A CE is defined in Article 1.3.1 to be "any Entity that is
78 included in a Group; and any Permanent Establishment of a Main Entity". In essence, a Canadian
79 CE is a Canadian corporation that is a member of an MNE group or a Canadian permanent
80 establishment of a foreign corporation that is a CE. Whether a Canadian CE has low-taxed
81 income determines whether it has any top-up tax, which turns on the Canadian ETR. The amount
82 of top-up tax of each CE is, in essence, the target of the DMTT.

83 A DMTT is a QDMTT if it computes low-taxed income and top-up tax due in the same ways as
84 the GloBE rules themselves and it is implemented and administered in a way that is consistent
85 with the Model Rules with no collateral or other benefits. The OECD is expected to develop
86 processes to help countries assess whether a proposed DMTT will constitute a QDMTT.

87 ## B. Top-up Tax

88 According to the OECD Model Rules, the ETR would be determined on a group basis by
89 reference to financial accounting income and adjusted covered taxes. If the Canadian ETR is
90 below 15%, the difference between 15% and the Canadian ETR would be the Top-up Tax
91 Percentage. The Canadian top-up tax would be Canadian excess profits (i.e., total financial
92 accounting income minus a percentage covered by the Substance-based Income Exclusion)
93 multiplied by the Top-up Tax Percentage.

94 Key steps in determining the ETR and top-up tax are the following:

95 a) A Canadian group would include all Canadian CEs.
96 b) The ETR for the Canadian group would be the aggregated Adjusted Covered Taxes
97 over the aggregated Net GLoBE Income for Canada.
98 - GloBE income is the Financial Accounting Net Income or Loss, adjusted in
99 accordance with the Model Rules (one of the adjustments is to add qualified
100 refundable tax credits).
101 - A group's net GloBE Income is the aggregate of GLoBE Income or Loss of
102 each entity of the Canadian group.
103 - The aggregate Adjusted Covered Taxes would essentially include federal and
104 provincial corporate income taxes (including both the current tax provision
105 and certain items of the deferred tax provision), adjusted in accordance with
106 the Model Rules.
107 c) Canadian Top-up Tax Percentage would be 15% minus the Canadian ETR.

108 d) Domestic Excess Profit of the Canadian group would be the group Net GLoBE Income
109 minus the Substance-Based Income Exclusion. The Substance-Based Income
110 Exclusion, after a 10-year transition period, would be 5% of eligible payroll and
111 eligible tangible asset costs in Canada.[8]
112 e) Canadian Top-up Tax would be determined as follows:
113

114
$$\begin{pmatrix}\text{Canadian}\\\text{Top-up}\\\text{Tax}\end{pmatrix} = (15\% - ETR) \times \left[\begin{pmatrix}\text{Net}\\\text{GloBE}\\\text{Income}\end{pmatrix} - \begin{pmatrix}\text{Substance}\\\text{based}\\\text{Income}\\\text{Exclusion}\end{pmatrix}\right] + \begin{pmatrix}\text{Additional}\\\text{Current}\\\text{Top-up}\\\text{Tax}\end{pmatrix} - \begin{pmatrix}\text{Qualified}\\\text{Domestic}\\\text{Top-up}\\\text{Tax}\end{pmatrix}$$

115

116 f) Allocating Canadian group top-up tax to each corporation:
117

118
$$\begin{pmatrix}\text{Top-up}\\\text{Tax of}\\\text{a CE}\end{pmatrix} = \begin{pmatrix}\text{Canadian}\\\text{Top-up}\\\text{Tax}\end{pmatrix} \times \left(\frac{\begin{pmatrix}\text{Globe}\\\text{Income}\\\text{of the CE}\end{pmatrix}}{\begin{pmatrix}\text{Aggregate}\\\text{Income of}\\\text{all CEs}\end{pmatrix}}\right)$$

119

120 The example below[9] shows simplified top-up tax calculations for an entity with the following
121 amounts:

[8] The transitional rules contemplate an initial rate of 10% of payroll costs and 8% of tangible asset costs, declining annually until the 5% rate is reached. If a Constituent Entity has no Eligible Payroll Costs and no Eligible Tangible Assets, the Jurisdictional Top-up Tax will be equal to 15% of the Net Globe Income of the jurisdiction. A minimum tax of 15% is indirectly achieved if the Jurisdictional Top-up Tax is charged to other Constituent Entities of the MNE Group elsewhere in the world. The tax is not paid to the low-tax jurisdiction, but it is charged to the MNE Group anyway. On the other hand, if the Constituent Entity (an hotel) in the same jurisdiction has significant Eligible Payroll Costs and significant Eligible Tangible Assets, the Jurisdictional Top-up Tax will not be equal to 15% of the Net Globe Income of the jurisdiction. A global minimum tax of 15% will not be achieved. For example, suppose that a Constituent Entity operates a hotel in a low-tax jurisdiction, that its Eligible Payroll Costs represent half of its annual income, that its Eligible Tangible Asset costs represent one third of it and that its Globe income is equal to 6% of it. In this example, the jurisdictional top-up tax will not represent 15%, but rather 4.58% of its Globe Income (which is less than 15%).

[9] Patrick Marley, Angelo Nikolakakis and Sue Wooles, “Pillar Two Update” in *Report of Proceedings of the Seventy Fourth Tax Conference*, 2022 Conference Report (Toronto: Canadian Tax Foundation, 2023), To be published).

Accounting income (+)/loss (-)	100,000
Excluded dividends (-) / equity gains (-)/loss (+)	(20,000)
Other adjustments (-)/loss (+)	0
[Net] GloBE Income (+) or Loss (-):	**80,000**
Current income tax expense per FS (+)	10,000
Adjustments (-)/(+)	0
Covered Taxes:	**10,000**
Deferred tax asset (-) or liability (+) per FS	0
Adjustments (-)/(+) and recasting, if required	0
Deferred Tax Adjustment Amount (TDTAA):	**0**
Adjusted Covered Taxes:	**10,000**
ETR - if positive, otherwise 0:	12.50%
TUTP - if positive, otherwise 0:	2.50%
GloBE Income (+) or Loss (-) - from above	80,000
EPC-based exclusion	1,000
ETA-based exclusion	2,000
Excess Profit (only +, 0 if -)	**77,000**
Top-up Tax (TUT):	**1,925**

122
123
124

125 C. A Soak-up Tax

126 A Canadian QDMTT can be designed as a soak-up tax in that it will pick up the Canadian top-up
127 tax that would otherwise be picked up by a foreign country through an IIR (e.g., the jurisdiction
128 where the UPE or IPE is located) or an UTPR (e.g., the jurisdiction where a sister corporation is
129 located).

130 A Canadian QDMTT can be designed to be "creditable dollar-for-dollar against the top-up tax
131 liability otherwise arising under Pillar Two."[10] "In effect, this allows [Canada] to collect the top-up
132 tax applicable to any low-taxed income of its domestic entities, rather than allowing the top-up
133 tax to accrue to the treasuries of other countries under the IIR or UTPR."[11] The effect of a
134 QDMTT is to change the order in which jurisdictions are entitled to charge top-up taxes where
135 the ETR of a CE falls below the 15% global minimum rate. A Canadian QDMTT is prioritized and
136 places Canada first in line to receive any tax-up tax revenue from CEs located in Canada.
137 Without the QDMTT, Canadian tax revenue would go to another country as determined by the

[10] Canada, Budget 2022, Tax Measures, supra note 3 at 39.

[11] Ibid.

138 Pillar Two order – top down from Ultimate Parent Entity jurisdiction to Intermediate Parent
139 Entity jurisdiction to any jurisdiction where a CE is located.[12]

140 III. SHOULD CANADA INTRODUCE A QDMTT?

141 If Canada's trading partners adopt IIRs and UTPRs and if Canadian CEs do have ETRs below 15%,
142 Canada should introduce a QDMTT as long as the advantages of a QDMTT outweigh the
143 drawbacks. The main advantages are revenue protection, not needing to rewrite tax incentive
144 rules and provide a safe harbour.[13] The main drawbacks are additional costs of compliance and
145 administration and uncertainty in federal/provincial sharing of the tax revenue.

146 A. Keeping Canadian Revenue in Canada

147 The issue of Canadian top-up tax under a QDMTT arises only with respect to Canadian CEs. The
148 vast majority of Canadian corporations will not be affected. The Canadian corporate tax system
149 works well in general. The nominal combined federal provincial tax rates on Canadian profits is
150 above 15%. In addition, as shown in Table 1, taking into consideration both federal and
151 provincial taxes, corporations paid 20% of tax on average in 2018.[14] The year 2018 was chosen
152 because it was the last full year before the pandemic. However, the year should not have a
153 significant influence on the reasoning.

---

[12] The ordering of certain foreign taxes – such as under foreign CFC rules – must also be considered, as discussed below in greater detail (see [***]).

[13] While this remains to be determined, a safe harbour approach could be developed by the OECD which would allow MNE groups to avoid having to produce calculations for IIR or UTPR purposes for CEs that are subject to a QDMTT. This could provide some administrative efficiencies.

[14] i.e. 92,619 / 464,920.

154 **Table 1: Financial and taxation statistics for Canadian enterprises**

	2018 Millions $	2018 Millions $
Profit before income tax	464,920	
Taxable income (tax base)	359,260	
Part 1 tax, otherwise payable	131,495	
Federal tax abatement	33,262	
Small business deduction	14,616	
Manufacturing and processing profits deduction	3,173	
Investment tax credit	1,786	
Other federal tax credits	28,724	
Net part 1 tax payable		49,935
Other direct federal taxes		6,375
Total federal tax		56,310
Provincial income taxes		36,308
Total taxes		**92,619**

155 Source: Statistics Canada. Table 33-10-0006-01 Financial and taxation statistics for enterprises, by industry type
156 (https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3310000601).

157 Table 1 shows two things. First, if corporations pay 20% of tax on average, an ETR of less than
158 15% could be unusual. Second, without taking into consideration the federal tax abatement and
159 the small business deduction, the Part I tax otherwise payable is reduced by approximately $34
160 billion[15]. This observation suggests that ETRs in Canada could vary quite significantly if
161 reductions are granted to a few targeted firms, rather than to all of them uniformly.

162 Table 1 provides some of the reasons why the ETR of a CE in Canada may be less than 15%,
163 although it does not provide them all. For example, the preferential tax treatment of capital
164 gains can also have a role in an ETR of less than 15%.

165 The role of the partial inclusion of capital gains is easy to understand. Assume that ForCo is the
166 UPE of a foreign headquartered MNE Group. It owns all the shares of CanCo, a resident in
167 Alberta, and the group's only subsidiary in Canada. CanCo's sole purpose is to own investment
168 property. When CanCo disposes of all its assets to an arm's length person, it realizes a capital
169 gain, half of which is taxable. Assuming a nominal combined tax rate of 23%, the ETR on the
170 capital gains will be 11.5%.

171 Regarding tax credits, it should be noted that the effect of a given tax credit on the ETR
172 computation is different, depending on whether it is refundable:

173 - A non-refundable tax credit reduces the covered taxes, while a refundable tax credit
174 increases GloBE income. For example, where a CE's Net GloBE income is $100 and

[15] This is a simple addition of the Manufacturing and processing profits deduction, with the Investment Tax credits, and the Other federal tax credits ($3,173 + $1,786 + $28,724 = $33,683).

175 covered tax is $15, $1 of non-refundable SR&ED credit would reduce the covered tax to
176 $14, resulting in an ETR of 14%.[16]

177 - A refundable tax credit does not reduce the Adjusted Covered Taxes. Instead, it increases
178 the Net GloBE income, and it may increase the Adjusted Covered Taxes. Suppose again
179 that the Net GloBE Income is equal to $100 and that the Adjusted Covered Taxes before
180 any credit are equal to $15.[17]
181   - First, if a refundable tax credit of $1 is paid, and if this $1 is not included in the
182   taxable income during the same year, the ETR falls to 14.85% (i.e. $15 / $101).
183   - Second, if a refundable tax credit of $1 is paid, and if this $1 is included in the
184   taxable income during the same year, the ETR remains at 15% (i.e. ((15% x 1) +
185   15)/101).

186 Refundable SR&ED credits are less relevant because they are offered to Canadian-controlled
187 private corporations that are unlikely to be CEs.

188 Among the federal tax incentives (see Table 2 and Table 3 below), the Scientific Research and
189 Experimental Development, Investment Tax Credit (SR&ED credit) is the most significant in both
190 formats - non-refundable tax credit and refundable tax credit.

191 **Table 2: Important Federal Tax Expenditures (Excluding Refundable Tax Credits) (2018)**

	Millions $
Partial inclusion of capital gains (CIT)	11,530
Scientific Research and Experimental Development, Investment Tax Credit (non-refundable portion for CIT)	1,415
Deductibility of charitable donations (CIT)	690
Accelerated Investment Incentive (sunset in 2027) (PIT and CIT)	385
Partial deduction of and partial input tax credits for meals and entertainment (CIT)	325
Atlantic Investment Tax Credit (non-refundable portion for CIT)	245
Other non-refundable credits[18]	480
Total	**15,070**

192 Note: CIT means corporate income tax, and PIT means personal income tax.
193 Canada, Department of Finance, *Report on Federal Tax Expenditures, Concepts, Estimates and Evaluations*, 2022, pages 29 to
194 40.

[16] Model Rules, supra note 2, Article 4.1.1. This is because the non-refundable tax credit decreases the current tax expense accrued in its Financial Accounting Net Income or Loss with respect to Covered Taxes for the Fiscal Year.

[17] Model Rules, supra note 2, Articles 3.2.4. and 4.1.2(d).

[18] Apprenticeship Job Creation Tax Credit ($85 million); Corporate Mineral Exploration and Development Tax Credit (phased out) ($80 million); Non-taxation of capital gains on donations of publicly listed securities ($75 million); Logging Tax Credit ($75 million); Deductibility of contributions to a qualifying environmental trust ($60 million); Holdback on progress payments to contractors ($50 million); Flow-through share deductions ($45 million); Exemption from branch tax for transportation, communications, and iron ore mining corporations ($10 million).

195 **Table 3: Federal Refundable Tax Credits (2018)**

	Millions $
Scientific Research and Experimental Development Investment Tax Credit (refundable portion)	1,405
Film or Video Production Services Tax Credit (refundable)	315
Canadian Film or Video Production Tax Credit (refundable)	270
Atlantic Investment Tax Credit (refundable portion)	25
Total	**2,015**

196 Note: CIT means corporate income tax, and PIT means personal income tax.
197 Canada, Department of Finance, *Report on Federal Tax Expenditures, Concepts, Estimates and Evaluations*, 2022, pages 29 to
198 40.

199 Provincial income tax incentives can also affect the ETR because provincial taxes are "covered
200 taxes." In Quebec (2016, the last year available): 36.4% of large multinationals paid no provincial
201 income tax; large multinationals benefited from 44.5% of the total tax credits granted by the
202 Quebec government;[19] and large companies received more than half of the tax credits aimed at
203 encouraging research and development and the new economy.[20] To the extent the credits are
204 non-refundable, they will affect the ETR in the same manner as the federal credits.[21]

205 As long as there is a Canadian top-up tax, a QDMTT will, in effect, recover this tax before any
206 foreign IIR or UTPR. In other words, the greatest advantage of a QDMTT in Canada is to ensure
207 that Canadian tax liability is always at the minimum set by Pillar Two, so that no country could
208 gain any right to tax Canadian income through Pillar Two.

209 It is difficult to estimate how much revenue could be raised through enacting the QDMTT. The
210 amount may be in the range of several hundred millions, which would account for the lion's
211 share of additional revenue gained through implementing Pillar Two in Canada.[22]

212 B. Preserving Canadian Autonomy in Using Tax Incentives

213 At a policy level, it can be difficult to change federal and provincial laws to ensure that the ETR
214 for CEs is always above 15%. It is unclear whether Canada should even try to ensure that the ETR
215 is always above the 15% threshold if it means abandoning the use of tax policy instruments for
216 social and economic purposes. A QDMTT would allow Canada to continue using tax incentives
217 without worrying about losing tax revenue to another country through Pillar Two. Of course,
218 Canada and provinces and territories could use the opportunity of implementing Pillar Two to
219 better coordinate their tax policies and reform the tax incentive rules, but the chance of that

[19] Id., page 47.

[20] Québec, Department of Finance, *Statistiques fiscales des sociétés, Année d'imposition 2016*, Québec, May 2022, page 120.

[21] In Quebec, the majority of provincial corporate tax incentives take the form of refundable tax credits. Québec, Deparment of Finance, *Dépenses fiscales, Édition 2018*, Québec, March 2019, page B.4 ("Québec Tax Expenditures"). Voir aussi Québec, Department of Finance, *Statistiques fiscales des sociétés, Année d'imposition 2016*, Québec, May 2022, page 44.

[22] See Jack Mintz (forthcoming in CTJ).

220 happening is remote. Therefore, even though a Canadian QDMTT would cancel or diminish the
221 effect of the tax incentives for CEs, it will help Canada preserve autonomy in retaining tax
222 incentives in general without leaving money on the table for other countries to grab through the
223 IIR or UTPR.

224 A QDMTT is a better policy choice than other measures to ensure meeting the Pillar Two
225 minimum threshold, largely because of the way in which ETR and top-up tax are computed
226 under the Model Rules. The ETR is determined by dividing Adjusted Covered Taxes by the Net
227 GloBE Income, whereas the top-up tax is determined by reference to excess profit, which is
228 GloBE *minus* the Substance-based Income Exclusion.

229 For example, Canada could not avoid triggering a top-up tax by taxing only Excess Profits at a
230 rate of 15% under a covered tax. Where Net GloBE Income is 1,000 and Substance-based
231 Income Exclusion is 900, Canada could choose to tax Excess Profit (100) at 15% (15) and
232 substance-based income at 0%, but the ETR would be 1.5% (15 covered tax/1000 GloBE Income).
233 This would mean that its Top-up Tax Percentage is 13.5%, which would be applied only to the
234 Excess Profit, yielding a top-up tax of 13.5 for IIR or UTPR purposes.

235 This approach to determining the ETR before excluding any income covered by the Substance-
236 based Income Exclusion, reflects what is sometimes referred to as a "tax adjustment" principle,
237 which holds that taxes should be viewed as having been applied to all income rateably, such
238 that the taxes imposed in this example should be viewed as having been applied not only to the
239 Excess Profits portion but also to the portion covered by the Substance-based Income Exclusion.
240 Thus, by allocating the taxes imposed in this manner, it follows that a rate of only 1.5% has been
241 imposed on the Excess Profits. A country would be required to impose covered taxes at a 15%
242 rate on all profits – including those covered by the Substance-based Income Exclusion – in order
243 to prevent a Top-up Tax Percentage from arising. In contrast, under a QDMTT, a country could
244 impose taxes at 15% only on Excess Profits, without triggering top-up taxes under another
245 country's IIR or UTPR.

246 C. Providing a Safe Harbour for Taxpayers

247 For taxpayers, a Canadian QDMTT would remove the Canadian top-up-tax that otherwise exists
248 from being considered in applying the IIR or UTPR in another jurisdiction. If the taxpayer feels
249 safer to do business with Canada than with a foreign country, to that extent, the QDMTT could
250 have the color of a safe harbour. However, the reasoning also goes in the opposite direction. If
251 the taxpayer prefers to do business with a foreign government, they may see the Canadian
252 QDMTT as a threat, more than as a safe harbour.

253 ## D. Drawbacks

254 The main drawbacks include added legislative complexity and costs of compliance and
255 administration. To ensure a DMTT is a QDMTT, the Canadian rules must satisfy some conditions,
256 such as: (a) determining the Excess Profits of the CEs located in Canada in a manner that is
257 equivalent to the GloBE Rules; (b) increasing Canadian tax liability with respect to Canadian
258 Excess Profits to the 15% ETR; and (c) being implemented and administered in a way that is
259 consistent with the outcomes provided for under the Pillar Two rules.[23] Because the GloBE rules
260 adopt financial accounting standards, concepts and rules that are not found in domestic law,
261 there will be uncertainties in transposing these rules into the Income Tax Act and provincial tax
262 laws. It might be difficult to be sure that the Canadian DMTT is "qualified" for Pillar Two
263 purposes. Furthermore, Canada may not have much say in the "qualification" process as it occurs
264 at the international (Inclusive Framework) level.[24]

265 As a matter of fiscal federalism, if a QDMTT is levied by the federal government and part of that
266 levy is attributable to a provincial incentive, it will be necessary to estimate the share of the
267 QDMTT that is attributable to this provincial incentive in order to return this share to the
268 province to which it belongs.

269 A major drawback of implementing Pillar Two and QDMTT is the cost for all stakeholders (both
270 in the public and private sectors). The information and data required to comply with the Pillar
271 Two rules do not readily exist; creating the necessary processes and mechanism to generate
272 such information and data take time and money. Implementing Pillar Two will be very complex
273 and costly. Implementing a QDMTT will add some costs, although additional costs may not be
274 high as the QDMTT is an add-on to the Pillar Two regime.

275 The risk of double taxation exists. This is particularly true if the Canadian minimum tax is not
276 "qualified" and fails to prevail over other countries' IIRs or UTPRs. The more "typical" risk of
277 double taxation arising from inconsistent application of the Model Rules in different countries
278 would be worsened by imposing the Canadian QDMTT. One example of inconsistent
279 application of the Model Rules is income earned by a controlled foreign affiliate (or corporation)
280 and the characterization of qualifying CFC tax.[25]

---

[23] Model Rules, supra note 2, page 64.

[24] A process similar to the "peer review" process to implement BEPS measures is expected to apply to "qualifying" DMTTs.

[25] See Model Rules, supra note 2, Article 10.1.1. and Part V of this paper.

IV. TECHNICAL DESIGN OF A CANADIAN QDMTT

A. Calculation

A Canadian QDMTT soaks up the Canadian Top-up Tax otherwise determined. In other words, it is what the Top-up Tax would be if there was no QDMTT.

$$\begin{matrix}\text{Qualified}\\ \text{Domestic}\\ \text{Top-up}\\ \text{Tax}\end{matrix} = (15\% - ETR) \times \left(\begin{matrix}\text{Net}\\ \text{GloBE}\\ \text{Income}\end{matrix} - \begin{matrix}\text{Substance}\\ \text{based}\\ \text{Income}\\ \text{Exclusion}\end{matrix} \right) + \begin{matrix}\text{Additional}\\ \text{Current}\\ \text{Top-up}\\ \text{Tax}\end{matrix}$$

For example, assume ACo, a resident of country A, owns all the shares of CanCo, a resident of Canada. Canco earns income of 100 and pays tax of 5. Canco has net GloBE Income of 100 and its substance based income exclusion is 20, resulting in excess profit of 80 (i.e. 100 – 20). If Canada has no QDMTT, the top-up tax will be equal to 8 (i.e. (15% - 5%) x 80). This top-up tax could be charged to ACo in country A through its IIR. If Canada wants to keep this 8 for itself, it can charge a tax of 8 under a QDMTT and reduce to zero both the Canadian Top-up Tax and the tax under an IIR or UTPR.

B. Liability to Tax

To be consistent with the GloBE rules, the Canadian QDMTT should have the same scope as the IIR and UTPR. It should apply to Canadian CEs that are part of a covered MNE group, whether the group has its head office in Canada or elsewhere. For groups headquartered in Canada, the QDMTT would trump a foreign UTPR in respect of the Canadian top-up tax. For groups headquartered overseas, the QDMTT would trump both a foreign IIR and UTPR.

The Model Rules do not prohibit a QDMTT from having a broader scope, such as smaller multinationals or purely domestic corporate groups. The EU directive applies to national as well as multinational corporate groups in order to comply with EU non-discrimination laws. The UK draft legislation aligns the scope of its QDMTT to the Model Rules. Canada can align with the UK.

C. The Amount of QDMTT

(1) Canadian excess profit

The notion of excess profit should be the same as that for computing the Top-up Tax. That is, it would be the amount of Net GloBE Income minus the Substance-based Income Exclusion, which will eventually be 5% of payroll costs plus 5% of tangible asset costs.

The Model Rules provide no specific attribution or source rules for determining excess profits for QDMTT purposes. It is clear, however, that such determination does not rely on the existing sourcing rules or attribution rules in domestic law or tax treaties. The Model Rules for determining Canadian top-up tax can be used for QDMTT purposes.

(2) Canadian top-up tax otherwise determined

The design goal of a QDMTT is to raise the Canadian domestic tax liability to the "floor" set by Pillar Two in circumstances where the ETR falls below 15%. The Model Rules do not define "domestic tax liability" for QDMTT purposes. Consistent with the object and purpose of Pillar Two and the design of IIR and UTPR, it is reasonable to suggest that a Canadian DMTT that equals the amount of Canadian top-up tax otherwise determined (i.e., the amount determined in the absence of a QDMTT) would be "qualified".

As discussed in Part II above, the calculation of Canadian top-up tax for the purpose of applying the IIR or UTPR relies on the determination of Canadian ETR, which is the amount of "adjusted covered taxes" divided by the Net GloBE Income in Canada. "Adjusted covered taxes" as defined in the Model Rules include not only Canadian income taxes but also certain taxes on foreign entities in the MNE group that are allocated to Canada (e.g., foreign tax on Canadian PEs, and on owners of certain flow-through entities, CFC taxes, and certain withholding taxes).[26]

(3) Allocation of QDMTT to each Constituent Entity

The purpose of the QDMTT is to reduce the Top-up Tax under IIRs and UTPRs to zero. Therefore, it must be equal to what the Top-up Tax would be if there were no QDMTT. This purpose continues at the CE level and the formula for allocating QDMTT between CEs should be the same as the formula for allocating Top-up Tax between them under an IIR or UTPR.

$$\begin{pmatrix}\text{QDMTT}\\ \text{of a Canadian}\\ \text{CE}\end{pmatrix} = \begin{pmatrix}\text{Canadian}\\ \text{QDMTT}\end{pmatrix} \times \left(\frac{\begin{pmatrix}\text{Globe}\\ \text{Income}\\ \text{of the CE}\end{pmatrix}}{\begin{pmatrix}\text{Aggregate}\\ \text{Income of}\\ \text{all CEs}\end{pmatrix}}\right)$$

This formula has some peculiarities that deserve to be noticed.

[26] It is not clear yet that the same approach to foreign taxes would be taken for the purposes of a QDMTT. See Brian Arnold, "An Investigation into the Interaction of CFC Rules and the OECD Pillar Two Global Minimum Tax", (2022, Vol.76, No.6) *Bulletin for Int'l Taxation*, June 2022 (IBFD)

336 1. This formulary allocation method is different from the one currently used to allocate
337 taxable income between provinces.[27]
338 2. A formulary allocation of QDMTT may cause a CE to pay this additional tax when its
339 actual ETR is above 15%, where it is a member of a Canadian group of CEs that as a
340 whole has a lower ETR.
341 3. The IIR does not always turn the entire Top-up Tax into a tax for a parent when that Top-
342 up Tax is in a CE that is not 100% owned.

343 These peculiarities are worth noting, but they do not change the fact that if the Canadian Top-
344 up Tax under an IIR or UTPR is to be equal to zero, after the application of QDMTT, the QDMTT
345 must be equal to what that Top-up Tax would otherwise be. Nothing in these peculiarities can
346 change that fact. In particular, if the QDMTT were set to be equal to the tax paid by the UPE
347 under the rules of the IIR and if that tax was different from that calculated under the QDMTT, a
348 residual Top-up Tax would survive and a tax under the rules of the IIR would also survive.

349 The computation of the Canadian QDMTT can be illustrated by the following example. [28]

350 Parentco, a resident of Country A, owns all the shares of Canco, a resident of Canada.
351 Canco carries on an active business in Canada and earns taxable income of 100. During
352 the fiscal year, it pays Canadian income tax of 12 (combined federal and provincial taxes).
353 Canco has net GloBE income of 200 and its substance-based income exclusion is 80,
354 resulting in excess profit of 120. Canco has 12 covered taxes.

355 Canco's ETR would be 6% (12 covered taxes divided by 200 GloBE income), and its top-
356 up tax percentage would be 9% (15% - 6%).

357 Canada's jurisdictional top-up tax would be 10.80, i.e., (9% x 120) (as the amount of
358 "Canadian top-up tax otherwise determined").

359 Canada can charge Canco a QDMTT of 10.80 (i.e., 15% - ETR x Excess Profit).

360 With the QDMTT in place, Canada's jurisdictional top-up tax becomes zero:

361 [(15% - ETR) x Canadian Excess Profit] – [(15% - ETR) x Canadian Excess Profit],

362 10.80 – 10.80 = 0

363 As such, there would be no Canadian top-up tax for Country A to tax under its IIR.
364 Canada's QDMTT displaces Country A's IIR top-up tax.

---

[27] ITA, s.124(1); Regulations 402.

[28] This is based on Example 6 in Arnold, supra note 26.

365 *(4) Variable Amount*

366 As discussed in Part V below, a qualified foreign CFC tax may reduce the amount of Canadian
367 QDMTT. In practice, it is likely very difficult for a Canadian taxpayer to know quickly the amount
368 of foreign CFC tax pushed down to Canada. For example, the United States GILTI regime[29]
369 operates on a worldwide basis, so it may be uncertain what proportion of tax under this regime
370 should be allocated to Canada when there may be many other entities within a worldwide
371 group. Canada will have to say what calculations taxpayers will have to make in these
372 circumstances.

373 D. Charging Rules

374 A charging rule to create the tax liability on Canadian constituent entities needs to be enacted. It
375 can be added as Division E.2 after the current Division E.1 Minimum Tax in section 127.5,
376 although it might be better located as part of the Pillar Two regime, consisting of the IIR, UTPR
377 and QDMTT. Isolating all the Pillar Two rules in a separate part of the Act may help Canada
378 "minimize" any potential, currently unknown or unknowable adverse spillover effect on the
379 operation of the general income tax system that has existed since 1917. To the extent that the
380 operation of the Pillar Two requires interaction with the general rules, such as the meaning of
381 undefined terms, such interaction may be kept at a minimum so that Pillar Two can be more or
382 less an "autonomous" part of the Canadian income tax system.

383 E. Administrative Rules

384 Canadian constituent entities liable to the QDMTT are likely required to self-assess the tax
385 through filing a tax return. Given the limited scope of the QDMTT, it may make sense to have a
386 special return as opposed to adding it to the general corporate return.
387

388 V. ORDERING OF TAXES

389 The ordering of taxes is important to the effectiveness of a Canadian QDMTT. Currently, the
390 Model Rules indicate that a foreign tax (such as CFC-related taxes) must be allocated to
391 Canadian covered taxes in the calculation of the Top-up Tax (foreign taxes take precedence over
392 the Top-up Tax), but they do not specifically say that the same rule should be applied in the
393 calculation of the QDMTT. The situation of a QDMTT is not quite the same as that of a Top-up
394 Tax and some might argue that the priority should not be the same. They would argue that the
395 QDMTT should have priority over foreign taxes. Either way, no matter which priority you choose,
396 the situation will not be perfect for the proper functioning of the QDMTT.

---

[29] For further discussion of the US GILTI and Pillar Two, see New York State Bar Association Tax Section, Report on the OECD Global Anti-base Erosion Model Rules (Pillar Two), July 21, 2022.

397 ## A. Ordering of Taxes in the Top-up Tax

398 A foreign CFC tax refers to a tax imposed on the foreign parent of a corporation in accordance
399 with a qualifying "Controlled Foreign Company Regime" ("CFC Regime", which is defined as "a
400 set of tax rules (other than an IIR) under which a direct or indirect shareholder of a foreign entity
401 (the CFC) is subject to current taxation on its share of part or all of the income earned by the
402 CFC, irrespective of whether that income is distributed currently to the shareholder."

403 To calculate a Canadian top up tax, the ETR for Canada is equal to the sum of the Adjusted
404 Covered Taxes of each Constituent Entity located in Canada divided by the Canadian Net GloBE
405 Income.[30] Adjusted Covered Taxes are the "normal" corporate income taxes (i.e. the current tax
406 expense accrued in its Financial Accounting Net Income or Loss) imposed by federal and
407 provincial governments[31] adjusted for some amounts, such as adding GloBE Loss Deferred Tax
408 Asset used[32] and deducting taxes refunded or credited (except for Qualifying Refundable Tax
409 Credits).[33]

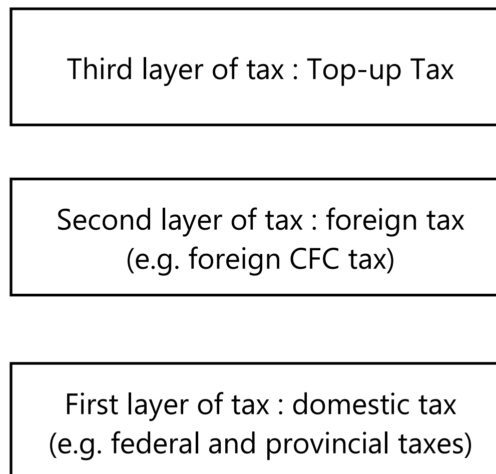
410 To understand the rest of this text, it is important to remember that for the purposes of
411 calculating the Top-up Tax, covered taxes of a jurisdiction include some taxes imposed by
412 another country (such as under CFC rules). The principle is that the first priority is given to the
413 normal taxes of the country where the source of the income is located. Thereafter, if a foreign
414 country imposes a tax on this same income, for example a tax under a CFC regime, this tax is
415 added to find the total taxes paid with respect to this income. Since the purpose of Pillar Two is
416 to find a missing tax, all taxes paid on the same income must be taken into account, regardless
417 of whether they are paid inside the source country or outside.

[30] Model Rules, Article 5.1.1. The Net GloBE Income is the difference between the GloBE Income and the GloBE Losses of all Constituent Entities located in a given jurisdiction. The GloBE Income or Loss is the net income or loss determined for a Constituent Entity (before any consolidation adjustments eliminating intra-group transactions) in preparing Consolidated Financial Statements of the Ultimate Parent Entity (Model Rules, Article 5.1.2.). Adjustments can be made under Article 3 by: adding Net Taxes Expense; adding or removing an amount to comply with the Arm's Length Principle; moving any Qualified Refundable Tax Credits from a reduction in tax to an increase in income; excluding International Shipping Income; allocating the income of a Flow-through Entity to the entity to which it belongs.

[31] Model Rules, supra note 2, Article 4.1.1.

[32] Model Rules, supra note 2, Article 4.1.2(b) and Article 4.5.3.

[33] Model Rules, supra note 2, Article 4.1.3(c).



418

419 A Jurisdictional Top-up Tax is a third layer of tax, on top of the CFC-type foreign tax which is
420 itself on top of the normal tax charged in the source country.

421 For example, suppose C-Co, a resident of country C, owns all the shares of D-Co, a resident of
422 country D, which in turn owns all the shares of E-Co, a resident of country E. E-Co earns an
423 income of 100 and pays a tax of 5 in country E. In addition, D-Co pays a tax of 6 in country D,
424 with respect to E-Co's income of 100, because there is a CFC regime in country D. E-Co has net
425 GloBE income of 100 and its substance based income exclusion is 20, resulting in excess profit of
426 80 (i.e. 100 – 20). Therefore, the ETR will be equal to 11% (i.e. (5 + 6)/100). If country E has no
427 Additional Current Top-up Tax and no QDMTT, the top-up tax will be equal to 3.2 (i.e. (15% -
428 11%) x 80). If country C has an IIR, C-Co will pay 3.2 to country C.

429 In this computation, the Adjusted Covered Taxes include all the amounts that were pushed
430 down from a foreign country under article 4.3.2 of the Model Rules, for example the amount of
431 tax paid in a foreign country according to a CFC regime.

432 B. Ordering of Taxes in the QDMTT

433 When calculating the Top-up Tax under an IIR or UTPR, priority is given to foreign tax. Therefore,
434 this tax (for example the tax paid in respect of a CFC) reduces the Top-up Tax. The third layer
435 passes after the second. With regard to QDMTT, the situation is not so clear and there is no
436 official position.

437 • Assuming that the QDMTT is part of Pillar Two, the QDMTT would belong to the third
438 layer of taxation. In this case, priority would be given to the foreign tax over the QDMTT.
439 For example, an increase in foreign tax on income from a CFC would reduce the QDMTT.
440 This would be the same calculation that is used to calculate the Top-up Tax under an IIR
441 or UTPR.
442 • On the contrary, assuming that the QDMTT is paid in the source country, the QDMTT
443 would belong to the first layer of taxation. In this case, priority would be given to the

QDMTT over the foreign tax. For example, an increase in the QDMTT paid by a CFC would reduce the foreign income tax relating to that CFC.

It is not easy to choose one or the other of the priorities. Both have serious drawbacks.

(1) Prioritize the foreign taxes over the QDMTT

If the priority rule that is used to calculate the QDMTT is not the same as the one used to calculate the Top-up Tax under an IIR or UTPR, the QDMTT may be different from the Top-up Tax, which contradicts the basic objective that one compensates the other. From this point of view, the priority used to calculate the QDMTT should be the same as for calculating the Top-up Tax under an IIR or UTPR, which means that foreign tax (such as tax on a CFC) should have priority over the QDMTT. In this scenario, both the QDMTT and the IIR or UTPR belong to the third layer of taxation.

It is nevertheless difficult to recommend this priority without concern because it has disadvantages, the importance of which may vary according to the circumstances and the evolution of tax policies.

The first problem is that of perverse incentives. If countries usually rely on the QDMTT to recover taxes that would otherwise be collected through an IIR or a UTPR, nothing would stop some countries from being the first to collect that money using a system that pushes what they levy down into CEs (under Article 4.3.2 of the Model Rules) as a CFC tax. The QDMTT would be totally or partially neutralized. For example, even if Canada had a QDMTT, another country could collect the Canadian Top-up Tax before it, through a foreign tax on Canadian CFCs.

The second problem is that of the determination of the foreign tax. If foreign tax has priority, the Canadian taxpayer would need to know how much it amounts to before calculating its QDMTT. This basic knowledge should not be taken for granted too quickly. The determination of whether a foreign tax qualifies for the allocation rule can also be uncertain.

For example, the United States GILTI regime operates on a worldwide basis, so it may be uncertain what proportion of tax under this regime should be allocated to Canada when there may be many other entities within a worldwide group. Ideally, the amount of tax due under the Canadian QDMTT is the same as the amount of Canadian top-up tax due under the IIR or UTPR in another country. However, this outcome cannot be guaranteed by Canadian law alone. There are potential issues of conflicts between Canadian rules and foreign rules, even if they all follow the Model Rules. It is not clear whether it would be possible to design a Canadian QDMTT without any calculation rules at all, simply charging an amount equal to whatever amount would otherwise be calculated by an applicable foreign IIR or UTPR. In other words, it is not clear that Canada can adopt a QDMTT that is phrased, essentially, in one sentence, that says: "Tax shall be imposed on each Canadian CE in an amount equal to the tax that would otherwise be imposed

479 in respect of that CE under a foreign IIR or UTPR". In theory, this should meet the "equivalent
480 outcomes" requirement, but would it meet the other requirements?

481

482 The third problem is that the QDMTT is a Canadian tax paid to the Government of Canada and
483 that it is difficult to accept that a foreign tax could reduce Canadian tax on Canadian profits.

484 *(2) Prioritize the QDMTT over foreign taxes*

485 The QDMTT is a Canadian tax paid to the Canadian government, so it should be considered part
486 of the first layer of taxation. In this scenario, the QDMTT should not be reduced by a foreign tax.
487 Quite the contrary. When a Canadian tax increases, a foreign tax must decrease. The QDMTT
488 should take priority over any foreign tax.

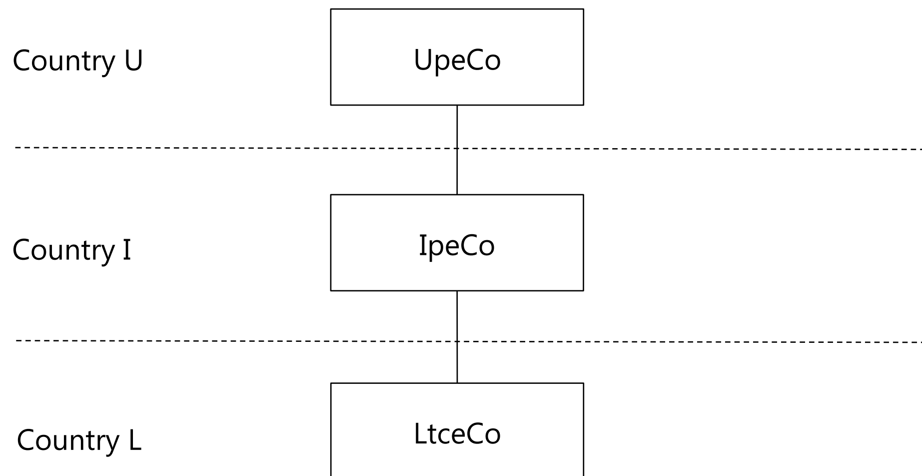
489 Although this reasoning seems quite natural, once again, it is nevertheless difficult to
490 recommend this priority without concern because it has disadvantages.

491 1) Pillar Two, including the QDMTT, are measures to "correct" the end result of all other tax
492 measures. In principle, they cannot therefore be an integral part of standard tax systems.
493 They have to be above it. They have to be on the third layer of taxation.
494 2) Taking into account the sequence of events in time, because of its corrective purpose,
495 Pillar Two, including QDMTT, must as a third layer come after foreign rules are applied
496 (including CFC rules), and after domestic rules are applied.
497 3) The principle of crediting the QDMTT inside a foreign tax regime could be a significant
498 challenge, since foreign rules, including the rules applicable to CFCs, are sometimes very
499 different from one country to the other. For example, even if the countries agreed to a
500 crediting principle, it is not certain that the QDMTT would reduce the tax relating to a
501 CFC to zero, because the CFC regimes do not follow the same rules as Pillar Two
502 (particularly in relation to the Substance Based Income Exclusion).
503 4) If the foreign tax relating to a CFC is not reduced to zero, the QDMTT would depend on
504 the foreign CFC tax (through the ETR), which would depend on the QDMTT (through the
505 credit). This is not in itself an insurmountable obstacle, but the complexity of the
506 situation would most certainly be undesirable.

507 Point number 3 is important. If it is assumed that the QDMTT must come before the foreign tax
508 on a CFC, it must be assumed to the end and taken for granted that the foreign tax which will be
509 allocated to Canada for the purposes of calculating the Top-up Tax will be reduced by any
510 Canadian QDMTT. This is the only way that the QDMTT fulfills its mission of reducing to zero
511 both the Canadian Top-up Tax and any foreign IIR or UTPR that would be calculated from this
512 Top-up Tax. If it were impossible for the TUT and the QDMTT to be calculated in the same way,
513 the system would no longer work.

B. Example

An example highlights the importance of the priority of taxes for the QDMTT. Suppose the Ultimate Parent Entity (UpeCo) resides in country U, the Intermediate Parent Entity (IpeCo) resides in country I, and the Low-Taxed Constituent Entity (LtceCo) resides in country L. UpeCo owns all the shares of IpeCo which owns all the shares of LtceCo. Countries U and I apply the GloBE rules and their tax rate is 25%. Country L does not apply the GloBE rules and its tax rate is 0%. The LtceCo Top-up Tax is $100.



Assuming that there is a CFC Tax Regime in country I, and that this regime applies to all income. Two situations are possible. First, the CFC Tax Regime has priority, and, second, the QDMTT has priority.

- Pillar Two determines that there is a problem because Country L doesn't charge enough tax. If the CFC Tax Regime has priority, Country I imposes a CFC tax of $100 on IpeCo, and this CFC tax completely "solves" the problem. This CFC tax is added to LtceCo's Covered Taxes. LtceCo's Top-up Tax is reduced to zero. Even if Country L has a QDMTT regime, it will not lead to any additional tax in Country L. Country L's QDMTT is rendered useless by Country I's CFC tax.
- If the QDMTT has priority, Country L imposes a QDMTT of $100 from LtceCo. This tax is credited against Country I's CFC tax of $100. IpeCo has no tax to pay with respect to the income earned in LtceCo.

Of course, if neither UpeCo nor IpeCo imposes a CFC tax, then Country U charges $100 tax from UpeCo under the IIR.

(3) Future negotiations

In today's environment, disadvantages arising from one priority or another are inherent to QDMTT. The importance of these disadvantages may vary depending on the circumstances. If necessary, countries can negotiate again to find a more comprehensive solution. To this end, it may be necessary to modify the rules applicable to CFCs.

CONCLUSIONS

Canada is not a country with zero or negligible nominal tax rates and its effective tax rate for all of its corporations is around 20%. Canada still offers a number of rules that can reduce tax and as it would be possible that the benefits of these rules are not granted uniformly to all corporations, it is also possible that certain CEs benefit from an ETR lower than 15%. Through an IIR or a UTPR, it would therefore be possible for a foreign country to take an amount of tax that a government in Canada has deprived itself of to achieve a tax policy objective. This is clearly not acceptable. To prevent it, there are two ways. The first is to revise the domestic law to prevent an ETR from falling below 15%. The second is to set up a QDMTT.

The revision of domestic law allows each government to keep what is rightfully its. It also allows governments to re-examine their incentives to avoid excesses. Finally, it avoids the costs of compliance, implementation and administration of a QDMTT. The downside of this revision (federally and in all provinces) is that the task could be daunting, especially if it needs to be done quickly. In addition, to avoid the application of the rules of IIR and UTPR, the ETR would have to be greater than 15%, which would undoubtedly be, in Canada, more demanding than introducing a QDMTT because the latter only applies to the portion of the profit that exceeds the Substance-based Income Exclusion.

The implementation of a QDMTT is very if not perfectly effective to compensate a Top-up Tax under an IIR or UTPR, because this tax exactly reproduces the calculation of a Top-up Tax under an IIR or UTPR if the same accounting standards are applied and assuming interpretive consistency. It therefore allows Canada to benefit from the advantages of Substance-based Income Exclusion. If Canada adopts a QDMTT, it therefore still retains part of its ability to give tax incentives below 15%. Apart from its costs, a QDMTT still has a number of disadvantages which are all challenges that will have to be resolved. First, a way will have to be found to share the proceeds of the QDMTT between the federal and provincial governments. Second, countries (or more precisely the Inclusive Framework) will have to decide on the priority to be given to certain foreign taxes over the QDMTT (or conversely to the QDMTT over certain foreign taxes). Third, if foreign taxes take priority, it will be necessary to estimate those foreign taxes to be included in the Canadian covered taxes.