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OECD Pillar 2: '15 Percent Minimum Tax' Deal Will See Canada Reduce Or Cannibalize Its Own GDP

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In this article, Boidman challenges claims that the OECD's pillar 2 minimum tax agreement will benefit Canada, taking particular exception to the Canadian government's implied claim that the tax will increase GDP by C $3.5 billion.

This article focuses on the yawning difference between the views of the Canadian government and some private sector observers concerning the impact that the 15 percent minimum tax in the OECD's pillar 2 agreement[1] will have on Canada.

Basic Positions

Contrary to Deputy Prime Minister and Minister of Finance Chrystia Freeland's recent *implied* claim (see below), Canada will not increase its GDP by C $3.5 billion per year under the October 8 OECD-brokered 136-country agreement on a 15 percent minimum tax for large multinationals.

Instead, that October 8 agreement will either lead to increased *foreign* government taxes on Canadian multinationals' operations in their jurisdictions (which will directly or ultimately reduce Canada's GDP) or see the Canadian government cannibalize those multinationals *without* any net increase in Canada's GDP.

Some Specifics

Freeland's *direct* claim, made in an October 16 interview with the Canadian Broadcast Corporation, Canada's national TV network, was expressed in Canadian government tax revenue terms, not GDP terms.[2] But the latter follows as explained below. She said the October 8 agreement (one part of which is labeled "pillar 2" and imposes the 15 percent minimum taxes) would open the door for Canada to collect C $3.5 billion per year of minimum tax and, separately (under pillar 1), C $1 billion per year of new tax on the digital profits of foreign digital giants, such as Google, derived from doing business in the Canadian market. Pillar 1 allocates taxing rights to countries in which multinationals with revenues of at least €20 billion (and profits therein of at least 10 percent) do at least €1 million of business. For these companies, 25 percent of profits above 10 percent of revenue may be taxed.

The Twisted Trail to GDP

The latter is part of the twisted trail from simple tax numbers to the effects on Canada's GDP. In the last few years, many countries, including Canada, decided to start taxing foreign digital giants — by overriding preexisting

[1] OECD, "Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy" (Oct. 8, 2021). The statement was endorsed by G-20 heads of state on October 30 in Rome. For background from a Canadian perspective, see Nathan Boidman and Michael N. Kandev, "Canada at the Crossroads of International Tax Reform: Between Harmonization and Tax Competition," 75(11/12) *Bull. Int'l Tax'n* (2021); and Boidman and Kandev, "Canada and BEPS: What Goes Around Comes Round," *Tax Notes Int'l*, June 28, 2021, p. 1815.

[2] *See* Stephanie Soong Johnston, "Freeland Says Global Tax Deal Will Raise $3.6 Billion for Canada," *Tax Notes Int'l*, Oct. 25, 2021, p. 436.

domestic tax law or tax treaty constraints — and to do so either under a global agreement (which finally was reached on October 8, though it now requires intricate implementation agreements and procedures) or unilateral domestic law, generally taking the form of a simple 3 percent levy on the gross sales in a country (known as a digital service tax).

Canada had planned but did not implement a 3 percent DST law.[3] It has now announced that it will abandon these efforts, provided the pillar 1 deal is brought into force by the beginning of 2024. If not, Canada will apply the 3 percent tax on gross sales, effective 2022.[4]

The Link — Pillar 1

Why is this pillar 1 tax on digital giants relevant to the minimum (pillar 2) tax and GDP?

Simple: Whether the tax on foreign digital giants doing business in Canada is on the 3 percent of gross basis or on the pillar 1 basis, it is expected to raise nearly C $1 billion of *new* tax revenue that will come out of the *hides* of foreign-based multinationals and *comprise a net addition* to Canada's wealth/GDP.

The Link — Pillar 2

But the latter is *not* the case with pillar 2. Pillar 2's 15 percent minimum tax essentially will see either (1) foreign countries increase their taxation of Canada's multinationals doing business in their jurisdictions,[5] decreasing — not increasing — Canada's wealth/GDP (aside from leaving no room for Canada to apply the minimum top-up tax) or (2) the Canadian government cannibalizing Canada's private sector *without* any net increase of our GDP.

Link to Tainted Election Platform on Pillar 2

Freeland failed to recognize this (in her Canadian Broadcast Corporation interview, where she said, "The math clearly works in Canada's favor under the global deal"). This fundamental GDP aspect of the government's plan to adopt hook, line, and sinker the OECD plan leads me back to a highly misleading claim relative to pillar 2 in the Liberals' recent (September 20) election campaign platform, which asserted, without any grounds, that the minimum tax would operate "so the biggest companies in the world are not able to escape the taxes they owe here in Canada." As I wrote in a Canadian newspaper:

> That assertion is nonsense for three inter-related reasons.
>
> First, Canada already has tax rules that protect the Canadian tax base of foreign-owned subsidiary corporations from being stripped out of Canada. These rules and the ones proposed in the most recent budget — including those on transfer pricing, thin capitalization and earnings stripping, tax-treaty shopping and hybrid structures, and the notorious foreign-affiliate dumping rules — do not need reinforcement by a global minimum tax and would not be reinforced by it.
>
> Second, Canada has announced plans (unrelated to the proposed global minimum tax) to create new taxes applicable to profits of foreign-based digital giants that are derived from selling digital services and goods in Canada, and which currently are not subject to Canadian tax.
>
> This is also an evolving creature of the OECD-led crusade against international tax planning, and several countries, including Canada, have announced they will implement their own version of such rules if the OECD project is not brought to a conclusion.
>
> Third — and the crucial factor here — the only effect in Canada of the global minimum tax initiative would be harm. That is because it would destroy 50 years of tax policy aimed at maximizing the international competitiveness of Canada's multinationals by interrelating two sets of rules: those that exempt from Canadian

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[3] *See* Boidman and Kandev, "Canada and BEPS," *supra* note 1.

[4] *See* Johnston, *supra* note 2.

[5] For example, this could see the United States extend the taxation of foreign-owned U.S. operating subsidiaries through tougher anti-stripping rules such as IRC section 163 or the Tax Cuts and Jobs Act, base erosion and antiabuse tax rules, or anti-hybrid rules.

tax the foreign profits of Canadian multinationals, and those that facilitate foreign tax planning with respect to such profits.[6]

This policy and these rules — the objectives of which are to optimize the robustness of Canada's multinationals and increase tax revenues from dividends they pay and capital gains derived from the disposition of their shares — were instituted with the massive tax reform of 1972.

A government-appointed panel chaired by former Bank of Nova Scotia chief executive officer Peter Godsoe reaffirmed them as recently as 2008.

But the proposed global minimum tax would violate those principles because, for example, the profits in the United States of a Canadian-based multinational's U.S. subsidiary would be taxed, whether by the source country (the U.S.), the home country (Canada) or a third country used to structure those U.S. operations. That is simply not what the architects of our tax system over the past 50 years have had in mind.[7]

At the time of the election campaign, one thought it would be unfortunate if this misconceived tax proposal that was so misunderstood by the Liberal campaign ever saw the light of day in Canada. But now that concern is, of course, exponentially increased as we have gone from a "proposed" minimum tax to a 136-country undertaking.

Any Solution?

Is there a solution, short of abrogating the October 8 agreement and subsequent G-7 approvals? Surprisingly, at least in theory, there may be an elegant solution.

An unexpected provision in the October 8 agreement is the right of any subscribing (agreeing) country to not "adopt the GLOBE [global anti-base-erosion] rules [a fancy term for pillar 2], but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two."[8] What this means for Canada and the concerns set out above is not totally clear, but I would urge the deputy prime minister to address that part of the October 8 agreement. ■

[6] It should be noted that the exemption entails Canada's foreign affiliate rules under sections 90-95 and 113 of the Income Tax Act of Canada and regulations made thereunder; the rule that facilitates foreign tax planning is section 95(2)(a)(ii) of the ITA.

[7] Boidman, "The Liberals' Tax Plan Distorts and Threatens Years of Canadian Tax Law," *The Globe and Mail*, Sept. 6, 2021, at B8.

[8] OECD, *supra* note 1, at 3.