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Tax Alert – Canada

Canada proposes amendments to the *Global Minimum Tax Act* and the *Income Tax Act*

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

The Department of Finance released several packages of draft legislative proposals for public comment on 15 August 2025 relating to the *Global Minimum Tax Act* (GMTA), the *Income Tax Act* (ITA) and the *Income Tax Regulations* (ITR).

The proposals relating to the GMTA contain a variety of measures to deal with Canadian specificities (e.g., introducing a new concept of "private investment entity" to address certain Accounting Standards for Private Enterprises (ASPE) concerns) and the OECD Administrative Guidance released after the GMTA was initially enacted.[1]

The package of proposals also contains measures relating to the integration of the GMTA with the ITA and, in particular, provides amendments to the foreign accrual property income (FAPI) and the surplus rules mainly to address taxes paid under a "domestic minimum top-up tax regime".

Notably, the proposals do not include the undertaxed profits rule (UTPR), which was previously included in the draft legislative proposals released on 12 August 2024. This omission could suggest that these measures may be deferred until the OECD releases the proposed side-by-side system that was announced by the G7 on 28 June 2025.[2]

[1] For more information, see EY Tax Alert 2024 Issue No. 36, *2024 federal budget implementation bill no. 1 receives Royal Assent*.
[2] For more information, see EY Tax Alert 2025 Issue No. 33, *G7 releases statement on Global Minimum Tax (Pillar Two) and Canada rescinds the digital services tax*.

Shape the future with confidence

In this Tax Alert, we provide a brief overview of certain measures included in the draft legislative proposals.[3]

Key changes introduced by the legislative proposals

Private investment entities

The proposal introduces into the GMTA (in proposed subsection 9(2.1)) the concept of "private investment entity" dealing with private entities located in Canada owning, directly or indirectly, a controlling interest in a publicly listed corporation, along with a related anti-avoidance rule.

The OECD Model Rules[4] list both International Financial Reporting Standards (IFRS) and the generally accepted accounting standards of Canada as Acceptable Financial Accounting Standards (i.e., the Canadian ASPE) for the purposes of computing any Pillar Two liabilities. However, the flexibility provided by the ASPE accounting standards — and in particular the "optionality" to perform a line-by-line consolidation of subsidiaries — has resulted in a number of practical concerns that often do not arise under other accounting standards that can be used for Pillar Two.

To address this Canadian-specific concern, the Department of Finance has introduced the concept of private investment entity. This concept is not included in the OECD Model Rules, and we are not aware of any other jurisdiction currently providing for a similar concept.

Under the proposal, an entity preparing accounts under ASPE that is not owned directly or indirectly by a publicly listed company, has opted to not perform a line-by-line consolidation, and owns directly or indirectly a controlling interest in a Canadian publicly listed company can be subject to a de-consolidation rule under the GMTA. If an entity (or multiple entities) can benefit from the de-consolidation rule, it will form a separate Pillar Two group from the one formed by the publicly listed group (and its subsidiaries). It is important to note that such entity remains subject to the provisions of the GMTA and hence will be subject to Pillar Two compliance and potentially top-up tax.

This proposed amendment applies to fiscal years of a qualifying MNE group that begin on or after 31 December 2023.

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[3] For more information on the packages of draft legislative amendments released on 15 August 2025 to implement certain previously announced tax measures, refer to EY Tax Alert 2025 Issue No. 40, *Finance releases draft legislation for various previously announced measures and technical amendments*.

[4] OECD, Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, 20 December 2021, https://www.oecd.org/en/publications/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en.html.

A couple of open points remain:

- At the time of writing, the OECD has not introduced an equivalent concept — raising questions on how other countries may react to these new measures.
- Additionally, the rules contained in the ITA related to the Country-by-Country Report (CbCR) provisions have not been amended to align to the above context. Since the CbCR and the Pillar Two rules have broadly the same scope, Canadian MNE groups benefiting from the above private investment entity concept may not be able to file their CbCR under the same perimeter, resulting in increased compliance burdens.

Reallocation of taxes

The legislative proposals include amendments to the rules relating to the reallocation of taxes to implement guidance introduced by the June 2024 OECD Agreed Administrative Guidance[5] in relation to the allocation of Covered Taxes in ownership structures involving Flow-Through Entities.

- **Flow-Through Entities – CFC taxes** — Subsection 24(3) of the GMTA was amended to ensure that covered taxes imposed under a controlled foreign company (CFC) regime on a constituent entity-owner in relation to a CFC that is a flow-through entity, and allocated under subsection 24(4) to that CFC, can be further allocated to another constituent entity-owner of the CFC. This rule applies in structures where the CFC owner holds its interest in the CFC through another constituent entity-owner that treats the CFC as a Tax Transparent Entity and includes the portion of the CFC income in its financial accounting income under subsection 17(6)(b) of the GMTA.
- **Controlled foreign companies – blended CFC regime** — The proposals include a number of adjustments to the CFC allocation rules in relation to a blended CFC regime (such as the US global intangible low tax income, now the net CFC tested income regime). The proposals exclude from the reallocation principle deferred taxes arising in respect of a blended CFC regime. Furthermore, the proposals introduce the blended CFC allocation key that was introduced in the Commentary to Article 4.3.2(c) of the OECD Model Rules.
- **Covered Taxes paid by indirect owners of Flow-Through Entities** — Subsection 24(5) of the GMTA was amended to address the allocation of Covered Taxes in multi-tiered structures involving Flow-Through Entities that are treated as opaque by an intermediary (direct) owner (hence, qualifying as Reverse Hybrid Entities), but as fiscally transparent by indirect owners. These changes reflect the OECD guidance introduced in section 5.6 of the OECD June 2024 Agreed Administrative Guidance. Where an indirect owner includes the Flow-Through Entity's income in its financial accounting income and pays tax on it, the amended subsection 24(5) of the GMTA requires that such taxes be pushed down to the Flow-Through Entity, to align the tax with the income at the entity level.

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[5] OECD, Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two) OECD/G20 Inclusive Framework on BEPS, published on 17 June 2024 (the June 2024 Agreed Administrative Guidance), https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-global-anti-base-erosion-rules-pillar-two-june-2024.pdf.

- **Optional opt-out of allocation of deferred taxes —** In line with the OECD June 2024 Agreed Administrative Guidance,[6] and reflective of the complexity of the "five step process" for reallocation of deferred taxes,[7] the proposals also introduce an elective opt-out of reallocation of certain deferred taxes. This is a five-year election.

Other amendments

In addition to the above, the proposals include a number of clarifications to the drafting of certain provisions, as well as adjustments to reflect guidance that has been released since the GMTA was enacted in June 2024.

To note, the proposals include the revised guidance on Article 9.1,[8] which addresses the treatment of certain deferred tax assets that arose prior to the application of the global minimum tax because of certain governmental arrangements or following the introduction of a new corporate income tax.

Additionally, an amendment is proposed to the definition of qualified domestic minimum top-up tax (QDMTT) safe harbour in section 44 of the GMTA to specifically refer to and expand the so-called "switch-off rule" that was released after July 2023. Under the switch-off rule, no exemption will be granted under the income inclusion rule (IIR) in Canada if the foreign QDMTT jurisdiction has a system in place targeted by the revised guidance on Article 9.1 — instead, any QDMTT liability will be credited in Canada, and top-up tax may still be levied under the IIR.

Integration with the ITA

In addition to the proposed changes to GMTA, the Department of Finance also proposed changes to the ITA to ensure further integration of the Pillar Two rules within the broader Canadian domestic tax landscape.

FAPI rules

The Canadian FAPI rules apply to include on a current basis amounts computed by reference to certain income earned by a controlled foreign affiliate (CFA) of a Canadian taxpayer, with a corresponding deduction for any foreign accrual tax (FAT) paid on the FAPI. FAPI as defined includes, among other things, income from property, which includes income from a business other than an active business and income from a non-qualifying business.

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[6] June 2024 Agreed Administrative Guidance, Section 4.2.
[7] June 2024 Agreed Administrative Guidance, Section 4.2, paragraph 44 (new paragraphs 71.4 to 71.15 of the OECD Commentary to Article 4.4.1).
[8] OECD (2025), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on Article 9.1 of the Global Anti-Base Erosion Model Rules, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-article-9-1-globe-rules-pillar-two-january-2025.pdf.

With the adoption of Pillar Two by a number of jurisdictions, questions arose as to whether the top-up tax paid in those jurisdictions under a domestic minimum top-up tax (DMTT) would be treated as an income or profits tax for purposes of determining the FAT deduction for FAPI purposes. The proposed legislation clarifies this in new subsections 91(4.01) to 91(4.03), which provide that DMTT taxes paid by foreign affiliates under a DMTT regime may be taken into account when determining the FAT deduction under subsection 91(4) where certain conditions are met. This proposal also contemplates situations where another constituent entity within the same jurisdiction pays the top-up tax amount for DMTT purposes. Under the new proposals, in order for the DMTT to be included as FAT, the ITA introduces a two-step test:

- An "income or profits component" test, which is met only if the tested portion of tax can reasonably be considered to be in respect of income or profits (as determined under the DMTT regime) of the particular affiliate or the shareholder affiliate, as the case may be; and
- An "activities component" test, which is met only if the income or profits ascertained under the income or profits component of the test can reasonably be considered to be derived from an activity the income, profit or gains from which are included in the particular affiliate's FAPI that formed part of the taxpayer's subsection 91(1) FAPI inclusion.

In addition, the proposed rules introduce an "exception" to prevent an amount of tax payable under the DMTT regime from being considered in computing the deduction available for FAT in respect of a foreign affiliate's FAPI to avoid circularity.

Note that these rules only consider (certain) DMTTs, but not top-up taxes levied under an IIR or UTPR. Indeed, under the GloBE Model Rules, qualifying IIR and UTPR should allow for CFC taxes (such as FAPI) to be "pushed down" when assessing the effective tax rate of a Constituent Entity. Allowing such taxes to be FAT would also introduce circularity.

For purposes of applying these rules as well as the changes described below to the Canadian surplus rules, a "domestic minimum top-up tax regime" is newly defined in proposed ITR 5907(1) as:

> *"any provisions under the tax laws of a country that can reasonably be considered to have been enacted or otherwise brought into effect by the country with the intention of implementing a "Qualified Domestic Minimum Top-up Tax" within the meaning of the Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two), published by the Organisation for Economic Co-operation and Development."*

This determination is clear where a jurisdiction has enacted a DMTT that is a QDMTT for Pillar Two purposes. However, it remains unclear as to whether certain jurisdictions may be considered to have a DMTT regime where they have intentionally deviated from the DMTT rules such that they never expect to be a QDMTT.

The new proposals are deemed to enter into force on 15 August 2025.

Canadian surplus rules

These rules, which provide a deduction under section 113 on dividends paid to a Canadian corporation in certain instances, have also been adapted to account for the various implications in respect of any top-up taxes paid by a foreign affiliate under a DMTT regime.

Broadly speaking, the definitions of "exempt deficit", "exempt surplus", "hybrid deficit", "hybrid surplus", "hybrid underlying tax", "taxable surplus" and "underlying foreign tax" are modified to ensure that DMTTs paid by foreign affiliates are included in computing their relevant surplus balances and/or underlying tax accounts. The amendments consider both situations where the QDMTT is paid by the entity itself or where QDMTT is paid on behalf of other entities (including where the other entity is a foreign affiliate and even in a non-foreign affiliate context).

It should be noted that the proposals do not contain any adjustments to the surplus rules relating to top-up taxes paid under an IIR.

What has not been included in the legislative proposals

UTPR

Contrary to the previous draft legislative proposals released in August 2024, the proposals do not include the UTPR.[9]

The UTPR is the third element of the Pillar Two GloBE Model Rules, operating as a backstop to the IIR (implemented in Canada as the "Global Minimum Tax") and the QDMTT (also included in the GMTA). Broadly, the UTPR requires a taxpayer to pay top-up tax relating to low-taxed profit of any group entity if it has not been already subject to an IIR. The UTPR liability is reduced by the amount of QDMTT paid on the low-taxed profit.

Under the previous legislative proposals, the UTPR was to enter into effect for financial years commencing on or after 31 December 2024, which is one year after the entry into effect of the Global Minimum Tax and the QDMTT in Canada. This could suggest these measures may be deferred until the OECD releases the proposed side-by-side system that was announced by the G7 on 28 June 2025.

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[9] For more information, see EY Tax Alert 2024 Issue No. 46, *Canada proposes the undertaxed profits rule and further amends the GMTA*.

Outstanding corrections to the GMTA

The GMTA currently contains certain typographical errors that still need to be addressed, including:

- Creating a cumulative condition rather than an alternative condition in the definition of "deduction/non-inclusion arrangement" for the transitional CbCR safe harbour rule (subsection 47(1) of the GMTA); and
- Incorrect cross-reference in subparagraph 22(2)(c)(ii) of the GMTA to paragraph 22(3)(d).

These corrections were not included in the legislative proposals and could lead to practical issues for taxpayers that are trying to apply Pillar Two rules.

Other

Finally, the proposals released on 15 August 2025 included specific rules on a number of other items, including on securitization vehicles and changes to the income tax convention interpretation act.

What's next

The draft GMTA legislative proposals will now continue to advance in the legislative process, with a consultation period having ended on 12 September 2025.

As further OECD guidance is anticipated, in particular in light of the G7 statement released on 28 June 2025, we should expect the GMTA to continue to require amendments in the future to remain aligned to the global framework.

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