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Tax Alert — Canada

Initial insights regarding the OECD Side-by-Side administrative guidance on Canadian taxpayers

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On 5 January 2026, the OECD released its highly anticipated Side-by-Side package in the form of new administrative guidance published in respect of the Global Anti-Base Erosion (GloBE) Model Rules approved by the OECD/G20 BEPS Inclusive Framework.

The Side-by-Side package includes an extension of the Transitional Country-by-Country Report (CbCR) Safe Harbour as well as four new permanent safe harbours in the form of a Simplified Effective Tax Rate (ETR) Safe Harbour, a Substance-based Tax Incentives (SBTI) Safe Harbour, the Side-by-Side Safe Harbour and an Ultimate Parent Entity (UPE) Safe Harbour.

In this Tax Alert, we provide a brief overview of certain measures included in the Side-by-Side package and the impact it may have on Canadian taxpayers by way of future anticipated changes in the *Global Minimum Tax Act* (GMTA) to align with these new measures. We also briefly summarize other recent Canadian developments with respect to the GMTA.

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Key changes introduced by the Side-by-Side package

On 5 January 2026, the OECD published new administrative guidance that was approved by the Inclusive Framework, which included the following changes to the safe harbour measures that are described in more detail in EY Global Tax Alert 2026-0123, *OECD releases Side-by-Side Package on Pillar Two Global Minimum Tax: First impressions*:[1]

- Simplifications consisting of a safe harbour based on a simplified ETR computation (Simplified ETR Safe Harbour), as well as a one-year extension of the Transitional CbCR Safe Harbour (TCSH).
- An SBTI Safe Harbour, which allows for certain Qualified Tax Incentives (QTIs) (i.e., expenditure-based and certain production-based tax incentives) to be treated as an addition to covered taxes, up to a certain amount based on substance.
- The Side-by-Side System, which consists of two safe harbours that apply to MNE Groups headquartered in jurisdictions recognized by the Inclusive Framework as having an eligible tax regime. The Side-by-Side Safe Harbour exempts those MNE Groups from the Income Inclusion Rule (IIR) and Undertaxed Profits Rule (UTPR) in all jurisdictions, whereas the UPE Safe Harbour only exempts the UPE jurisdiction from the UTPR. The Side-by-Side System leaves any jurisdictions already subject to a Qualified Domestic Minimum Top-Up Tax (QDMTT) to be unaffected.

The following table outlines a summary of the available temporary and permanent Safe Harbours (using a calendar year as an example):

	2024	2025	2026	2027	2028
Transitional CbCR Safe Harbour	Yes	Yes	Yes	Yes	No
Transitional UTPR Safe Harbour	Yes	Yes	No	No	No
Permanent QDMTT Safe Harbour	Yes	Yes	Yes	Yes	Yes
Permanent Simplified ETR Safe Harbour	No	No	Yes	Yes	Yes
Permanent SBTI Safe Harbour	No	No	Yes	Yes	Yes
Permanent Side-by-Side Safe Harbour	No	No	Yes	Yes	Yes
Permanent UPE Safe Harbour	No	No	Yes	Yes	Yes

[1] Additional details with respect to these measures will be provided in future EY Global Tax Alerts.

Impact to Canadian outbound MNE Groups

Canadian MNE Groups that are currently relying on the TCSH rules may continue to benefit from the extension included in the administrative guidance provided they meet one of the three safe harbour tests (i.e., de minimis, routine profits or simplified ETR) alongside the required compliance obligations. Where Canada is the UPE jurisdiction, the extension of the Transitional UTPR Safe Harbour should not provide any benefit as Canada is a jurisdiction that has implemented the Pillar Two rules.

The most meaningful change commencing 1 January 2026 is expected to be as a result of the introduction of the new QTI concept, which provides much-needed relief for Canadian multinational groups that undertake a significant amount of R&D activity in Canada.
The utilization of the corresponding investment tax credits (ITCs) may have previously been subject to top-up tax as the Canadian incentives largely did not qualify for favourable treatment under the Qualified Refundable Tax Credits (QRTC) or Marketable Transferable Tax Credits (MTTC) rules. See below for additional insights on the QTIs and how they should be considered in the Canadian context.

Also effective for fiscal years commencing on or after 1 January 2026 is the new permanent Simplified ETR Safe Harbour rules. Although these rules are intended to be relieving in nature, given the number of adjustments required to arrive at the ETR, that may not be the case and may result in increased cost to compute and adhere to these rules. If so, taxpayers may continue performing full GloBE calculations under Part 2 (IIR) and Part 3 (QDMTT) of the GMTA as an alternative.

Finally, the new permanent Side-by-Side Safe Harbour and permanent UPE Safe Harbour are not expected to impact Canadian MNE Groups unless changes are undertaken and an application is made with the OECD to become a Qualified Side-by-Side jurisdiction. All existing obligations under the GMTA should continue to apply effective 31 December 2023.

Impact to non-Canadian MNE Groups

Similar to the above, any Canadian constituent entity that is part of an MNE Group subject to the Pillar Two rules may benefit from the extension of the TCSH rules pertaining to Canadian QDMTT, as well as the new QTI rules and the Simplified ETR Safe Harbour rules for fiscal years beginning on or after 1 January 2026.

Substance-based Tax Incentives Safe Harbour

The SBTI Safe Harbour allows an MNE Group to treat QTIs as an addition to the Covered Taxes of the Constituent Entities located in the jurisdiction. A QTI is an incentive generally available to taxpayers and calculated based on expenditures incurred (an expenditure-based incentive) or on the amount of tangible property produced in the jurisdiction (a production-based tax incentive). A Substance Cap limits the allowance for QTIs based on the amount of substance in the jurisdiction. The cap is equal to the greater of 5.5% of the payroll costs or depreciation of tangible assets in the jurisdiction. On an elective basis, the MNE Group can use an alternative cap that is equal to 1% of the carrying value of tangible assets in the jurisdiction, which may be beneficial in earlier years where the carrying value of such assets may be higher.

Unlike QRTCs and MTTCs, QTIs are excluded from GloBE Income. Therefore, the treatment of an incentive as a QTI could be more beneficial than the treatment provided for QRTCs and MTTCs. An MNE Group can make an annual election to treat certain QRTCs or MTTCs as a QTI. Under this election, the QRTC or MTTC is excluded from GloBE Income and is treated as a reduction to Adjusted Covered Taxes, before the QTI adjustment to increase Adjusted Covered Taxes is applied in the same way as it applies to any other type of QTI. The Substance Cap limits the total adjustment for QTIs.

A Filing Constituent Entity can make the SBTI Safe Harbour election for a Tested Jurisdiction for a Fiscal Year that begins on or after 1 January 2026.

Certain Canadian credits, including most federal and provincial scientific research and experimental development (SR&ED) ITCs, are non-refundable credits and can only be credited against an entity's corporate income tax liability. Absent the SBTI Safe Harbour, such credits are treated as a reduction to Covered Taxes for Pillar Two purposes when utilized. In certain circumstances, the utilization of these credits may result in Pillar Two top-up tax under the Canadian QDMTT rules. The SBTI Safe Harbour will allow for a portion or all of these credits to not be treated as a reduction to Covered Taxes, allowing MNEs with Canadian credits to utilize such credits without creating top-up tax in Canada.

Note that the Canadian clean economy ITCs, designed to incentivize investment in the transition to net-zero emissions, are generally characterized as QRTCs for Pillar Two purposes. However, these credits and other QRTCs can still be characterized as a QTI through the annual election described above.

The following table outlines an example of the SBTI Safe Harbour:

	2026 (in thousands)
Total payroll spend	$7,500
Pre-tax income – before non-refundable ITCs	$6,000
Tax rate	26.5%
Tax expense – before non-refundable ITCs	$1,590
Payroll eligible for SR&ED ITC	$4,000
Prescribed proxy amount [55% of eligible payroll costs]	$2,200
Total amount eligible for SR&ED ITC (eligible payroll plus prescribed proxy amount)	$6,200
ITC Rate (federal and provincial)	18%
ITC Generated [$6,200 * 18%]	$1,116
Substance Cap – 5.5% of total payroll spend (default, assumes no elections made and payroll expense exceeds depreciation)	$413
Maximum ITC Claim – Pillar Two not applicable	**$1,116**
Maximum ITC Claim without SBTI Safe Harbour before triggering top-up tax [i.e., $1,590 – [$6,000 * 15% Minimum Rate]]	**$690**
Maximum ITC Claim with SBTI Safe Harbour before triggering top-up tax [Maximum without SBTI Safe Harbour regime, plus the Substance Cap]	**$1,103**

What has not been included in the administrative guidance

Although the new administrative guidance provided a much-needed framework around the permanent safe harbours, a number of key open points remain:

- Although the Pillar Two rules are intended to apply consistently across jurisdictions based on a common set of rules and guidance with information return data to be available to all relevant tax authorities, administrative challenges will result. Countries are implementing rules at different paces, which may lead to a risk of fragmentation and differences in the interpretation and application of the rules. It is unclear at this time how dispute resolutions will be addressed.

- The Inclusive Framework determines whether a jurisdiction can benefit from the Qualified Side-by-Side or UPE Regime and subsequently lists it as such on the *Central Record for purposes of the Global Minimum Tax* published by the OECD. At the date of the publication of the Side-by-Side package, the United States is the only jurisdiction listed as having a Qualified Side-by-Side Regime, and no jurisdiction is listed as having a UPE Regime. Stakeholders will need to monitor which jurisdictions may benefit from the permanent Side-by-Side and UPE Safe Harbours.

- The Side-by-Side package indicates that the Inclusive Framework will continue working on technical clarifications and simplifications, including for the application of the GloBE Model Rules, as well as on integrity rules, such as finishing the ongoing work on a permanent routine profits test and a de minimis test, continuing to work towards further simplification of the GloBE Rules, taking forward further administrative guidance on technical issues relating to the GloBE Rules, exploring integration of the simplified calculations in the Simplified ETR Safe Harbour into the design of the GloBE Rules and streamlining reporting obligations.

Other relevant Canadian developments

In Canada, updates to the GMTA are expected to integrate the Side-by-Side package as well as a number of other previously unaddressed items.

As discussed in our previous Tax Alerts, the 2025 federal budget confirmed that the government will proceed with the legislative proposals released on 12 August 2024 (which included the UTPR) and 15 August 2025 to amend the GMTA.[2] The extent to which these proposals will be modified to take into account consultations that occurred since their release is unclear. However, now that the Side-by-Side package has been released, Canada's position with respect to the UTPR will need to be clarified to confirm whether Canada still intends to proceed with enacting these provisions.

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[2] For more information, see EY Tax Alert 2025 Issue No. 52, *Federal budget 2025*; EY Tax Alert 2025 Issue No. 44, *Canada proposes amendments to the Global Minimum Tax Act and the Income Tax Act*; and EY Tax Alert 2024 Issue No. 46, *Canada proposes the undertaxed profits rule and further amends the GMTA*.

Another notable development is the release by CRA of the first two technical interpretations dealing with the GMTA.

- In technical interpretation 2025-1073271E5, the CRA confirmed that an MNE Group may re-file its country-by-country (CbC) report after its statutory due date and rely on this re-filed CbC report for TCSH purposes, provided that the CbC report is filed before the GloBE Information Return for that fiscal year has been filed. This confirmation is a positive development that will allow for any errors that may be in the CbC report to be corrected to allow taxpayers to ensure they can still meet the requirements to have a qualified CbC report, which is required in applying the TCSH rules.
- In technical interpretation 2025-1072361E5, the CRA clarified that a Canadian partnership should generally be considered a stateless entity for the purpose of the CbC reporting rules, while a disregarded US limited liability company that is wholly owned by a US corporation should generally be considered resident in the US for the purpose of the CbC reporting rules. This is a helpful interpretation, as the CRA had not previously confirmed these points, and is relevant in ensuring Canadian taxpayers prepare the CbC report correctly so that they have a qualified CbC report for TCSH purposes.

What's next

Further OECD guidance is anticipated in the next six months to clarify the new permanent safe harbour measures, which will need to be monitored by various MNE Groups. Thereafter, further developments are expected by way of additional clarifications to the model rules and through the stocktake, the process by which the Inclusive Framework will agree to and will conclude by 2029 to ensure any unintended effects are addressed with an aim to ensure any material imbalances are addressed.

The OECD administrative guidance will have to be drafted and implemented into law by way of the GMTA along with the other various technical amendments released to date in order to remain aligned to the global framework.[3]

Learn more

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[3] For more information, see EY Tax Alert 2025 Issue No. 52, *Federal budget 2025*.

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