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Payment to non-residents of Canada: How can the Multilateral Instrument (MLI) be applied?

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The internationalization of trade has led to an increase in payments made by Canadian companies to non-residents of Canada, which are most of the time subject to Canadian withholding taxes. Canadian payers must ensure that they withhold the correct percentage of Canadian tax on such payments, as they are liable to the tax authorities for any failures on their part in this regard. In addition, payment recipients will normally want to minimize Canadian withholding taxes and ensure that they have benefitted from the lowest applicable rate.

Canadian Tax Treaties

In many cases, determining the Canadian withholding tax rate will depend on the application of a tax treaty between Canada and the payment recipient's country of residence for tax purposes. Canadian tax treaties may reduce the rate of the tax that a Canadian payer must withhold. If interpreting tax treaties was already complex in many situations, it has become even more so with Canada's adoption of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* ("Multilateral Instrument" or "MLI").

Since January 1, 2020, the MLI generally applies to most tax treaties between Canada and other countries, and its application may result in the non-application of certain provisions of a tax treaty. In such situations, a Canadian payer will be required to withhold the rate provided for in the *Income Tax Act* ("ITA"), that is, 25%, instead of the reduced rate provided for in the tax treaty between Canada and the recipient's country of residence for tax purposes, which will typically vary from 0% to 15%, depending on the type of payment involved and the recipient's tax status.

The application of the Multilateral Instrument (MLI)

For the time being, applying the Multilateral Instrument (MLI) is tricky for several reasons. First, the

MLI does not apply to all of Canada's tax treaties, nor to all of the articles of the treaties to which it does apply. It thus becomes necessary to first verify whether the MLI applies to a reduction in the withholding rate provided for in a Canadian tax treaty. Second, the Multilateral Instrument (MLI) provides for a general anti-avoidance rule with rather unclear application criteria. When the rule does apply, it may have the effect of denying a benefit provided for in a tax treaty.

In short, the MLI is making the application of the ITA's withholding tax on payments to non-residents more complex. Given that Canadian tax authorities will now apply the Multilateral Instrument (MLI), Canadian taxpayers should exercise caution and obtain proper advice before applying a rate less than the ITA's 25% rate.

Our taxation team is available to assist you and answer your questions regarding the application of the Multilateral Instrument (MLI) to payments made to non-residents.