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Budget 2021: International tax measures

April 20, 2021

The government announced the following international tax proposals in the 2021 Federal Budget. Below we outline the key details organizations with international affairs need to understand.

Interest deductibility

The Budget aligns the Canadian interest deductibility rules with the recommendations from the Organization for Economic Co-operation and Development (OECD). Interest deductions can be used to erode a country's tax base; all G7 countries except Canada have taken action as a result of the Base Erosion and Profit Shifting (BEPS) project by the OECD to limit excessive interest deductions.

Starting in 2023, the Budget will limit interest deductions to a fixed ratio of tax EBITDA, which is a corporation's taxable income before taking into account interest expense, interest income, income tax and deductions for depreciation and amortization. The fixed ratio is 40% for taxation years beginning on or after January 1, 2023 and 30% for taxation years beginning on or after January 1, 2024. Any denied interest can be carried back three years and forward 20 years. Standalone Canadian corporations and Canadian corporate groups that do not have non-resident members are not expected to be subject to these proposed interest deductibility restrictions.

The Budget does not provide exemptions to any industries (i.e. highly leveraged industries). This measure would apply to existing and new borrowings in respect of taxation years that begin on or after January 1, 2023. Draft legislative proposals are expected to be released for comment in the summer.

Hybrid mismatch

Hybrid arrangements can be used to exploit tax differences between Canadian and foreign income tax laws. Budget 2021 proposes to eliminate the tax benefits from hybrid mismatch arrangements. These proposals would be implemented in stages starting July 1, 2022. Draft legislative proposals are expected to be released for comment late in 2021.

Transfer pricing

The Budget announced the government's intention to consult on Canadian transfer pricing rules given recent Canadian court decisions on transfer pricing matters. A consultation paper is expected to be released within the next two or three months.

For more information, please contact:

[Dave Walsh](#), Managing Partner, Tax Service Line

[Harry Chana](#), Partner, International Tax Practice Leader and Transaction Tax Leader

The information in this publication is current as of April 19, 2021.

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