

# Legislative Proposals Relating to the Income Tax Act

## Hybrid Mismatch Arrangements

### **1 (1) The *Income Tax Act* (the “Act”) is amended by adding the following after section 12.6:**

#### **Hybrid mismatch arrangements – definitions**

**12.7 (1)** The definitions in subsection 18.4(1) apply in this section.

#### **Secondary rule – conditions for application**

**(2)** Subsection (3) applies in respect of a payment of which a taxpayer is a recipient if

- (a)** the payment arises under a hybrid mismatch arrangement; and
- (b)** there is a foreign deduction component of the hybrid mismatch arrangement.

#### **Secondary rule – consequences**

**(3)** Subject to subsection 18.4(5), if this subsection applies in respect of a payment of which a taxpayer is a recipient, an amount equal to the hybrid mismatch amount in respect of the payment shall be included in computing the taxpayer's income

- (a)** from the same source as the payment; and
- (b)** for the last taxation year of the taxpayer that begins before the end of the first foreign taxation year of any entity in which an amount in respect of the payment, in the absence of any foreign expense restriction rule, would be – or would reasonably be expected to be – deductible in computing relevant foreign income or profits of the entity.

**(2) Subsection (1) applies in respect of payments arising on or after July 1, 2022.**

### **2 (1) The Act is amended by adding the following after section 18.3:**

#### **Hybrid mismatch arrangements – definitions**

**18.4 (1)** The following definitions apply in this section and paragraph 20(1)(yy).

**Canadian ordinary income**, of a taxpayer for a taxation year in respect of a payment, means an amount that is

- (a)** if the taxpayer is not a partnership, included in respect of the payment in computing, in the case of a taxpayer resident in Canada, the income of the taxpayer for the purposes of this Part – or, in the case of a taxpayer that is a non-resident person, the taxable income earned in Canada of the taxpayer – for the year, except to the extent that
  - (i)** the amount is included in the Canadian ordinary income of any taxpayer under paragraph (b) or (c),
  - (ii)** the taxpayer is entitled to a deduction under section 112 or 113 in respect of the payment, or
  - (iii)** the amount can otherwise reasonably be considered to be excluded, reduced, offset or otherwise effectively sheltered from tax under this Part by reason of any exemption, exclusion, deduction, credit (other than a credit for a tax substantially similar to tax under Part XIII) or other form of relief under this Act that
    - (A)** applies specifically in respect of all or a portion of the amount and not in computing income generally, or
    - (B)** arises in respect of the payment;

(b) if the taxpayer is a partnership, determined by the formula

$$A \times B/C - D$$

where

**A** is an amount that is included in respect of the payment in computing the income or loss of the partnership from any source, or from sources in a particular place, for the year, except to the extent that the amount,

(i) is included in the Canadian ordinary income of any taxpayer under paragraph (c), or

(ii) can reasonably be considered to be excluded, reduced, offset or otherwise sheltered by any reason described in subparagraph (a)(iii),

**B** is the total of all amounts, each of which is, in respect of the partnership's income or loss from that source or the sources in the particular place for the year,

(i) the share of a member of the partnership that is a person resident in Canada, or

(ii) the share of a member of the partnership that is a non-resident person to the extent it is included in computing the non-resident person's taxable income earned in Canada,

**C** is the income or loss of the partnership from the source, or the sources in the particular place, for the year, and

**D** is the total of all amounts, each of which is an amount deductible, in respect of the payment, by a member of the partnership under section 112 or 113; or

(c) determined by the formula

$$E \times F$$

where

**E** is the amount determined by the formula

$$G \times H$$

where

**G** is an amount that is included in respect of the payment in computing the foreign accrual property income of a controlled foreign affiliate of the taxpayer for a taxation year (as defined in subsection 95(1)) of the affiliate ending in the year, except to the extent the amount can reasonably be considered to be excluded, reduced, offset or otherwise effectively sheltered by any reason described in subparagraph (a)(iii),

**H** is the aggregate participating percentage (as defined in subsection 91(1.3)) of the taxpayer in respect of the affiliate for the taxation year of the affiliate, and

**F** is

(i) if the taxpayer is a partnership, the amount determined by the formula

$$I/E$$

where

**I** is the total of all amounts each of which is a share of the amount determined for E of a member of the partnership that is a person resident in Canada, and

(ii) in any other case, 1. (*revenu ordinaire canadien*)

**controlled foreign company tax regime** means a set of provisions under the tax laws of a particular country other than Canada under which a direct or indirect shareholder of an entity that is located in a country other than the particular country is subject to current taxation in respect of its share of all or part of the income earned by the entity, irrespective of whether that income is distributed currently to the shareholder. (*régime fiscal des sociétés étrangères contrôlées*)

**deductible**, in reference to an amount in respect of a payment, in computing relevant foreign income or profits, includes any relief that arises in respect of the payment and is equivalent in effect to a deduction, including:

- (a) an exemption or exclusion in computing the relevant foreign income or profits; or
- (b) a refund of, or credit that can be applied to reduce or offset, income or profits tax paid or payable to a government of a country other than Canada in respect of the relevant foreign income or profits. (*déductible*)

**entity** has the same meaning as in subsection 95(1). (*entité*)

**equity interest** means any of the following:

- (a) a share of the capital stock of a corporation;
- (b) an interest as a beneficiary under a trust;
- (c) an interest as a member of a partnership; or
- (d) any similar interest in respect of any entity. (*participation*)

**equity or financing return** means a payment that can reasonably be considered to be in respect of, or determined by reference to,

- (a) revenue, profit, cash flow, commodity price or any other similar criterion;
- (b) dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation, or income or capital paid or payable to any member of a partnership or beneficiary under a trust, or any other distribution in respect of any entity; or
- (c) an amount arising as, on account of, in lieu of payment of or in satisfaction of, interest, or otherwise as compensation for the use of money. (*rendement financier ou de capitaux propres*)

**financial instrument** means

- (a) a debt;
- (b) an equity interest or any right that may reasonably be considered to replicate a right to participate in profits or gain of any entity; or
- (c) any other arrangement that gives rise to an equity or financing return. (*instrument financier*)

**foreign expense restriction rule** means a provision under the tax laws of a country other than Canada that can reasonably be considered to

- (a) have an effect, or be intended to have an effect, that is substantially similar to subsection 18(4) or 18.2(2); or
- (b) have been enacted or otherwise brought into effect by the country with the intention of implementing, in whole or in part, the *Global Anti-Base Erosion Model Rules* set out in *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 on December 20, 2021. (*règle étrangère de restriction des dépenses*)

**foreign hybrid mismatch rule** means a provision, under the tax laws of a country other than Canada, that can reasonably be considered to

- (a) have been enacted or otherwise brought into effect by the country with the intention of implementing, in whole or in part, the Final Report on *Neutralising the Effects of Hybrid Mismatch Arrangements* published by the Organisation for Economic Co-operation and Development on October 5, 2015, as amended from time to time; or
- (b) have an effect that is substantially similar to a provision under this section, section 12.7 or subsection 113(5). (*règle étrangère d'asymétrie hybride*)

**foreign ordinary income**, of an entity for a foreign taxation year in respect of a payment, means an amount that is determined by the formula

$$A - B - C - D - E - F$$

where

**A** is an amount (referred to in this definition as the “relevant amount”) that is included in respect of the payment in computing relevant foreign income or profits of the entity for the year (other than income or profits in respect of which the entity is subject to a tax substantially similar to tax under Part XIII, or a tax under a controlled foreign company tax regime or a specified minimum tax regime) because the entity is a recipient of the payment or has a direct or indirect equity interest in a recipient of the payment;

**B** is

(a) if the relevant amount is included in computing relevant foreign income or profits in respect of which the entity is subject to an income or profits tax that is charged at a nil rate, the relevant amount; or

(b) in any other case, nil;

**C** is any portion of the relevant amount that is included in computing relevant foreign income or profits of the entity for the year because of any foreign hybrid mismatch rule (other than any rule that is substantially similar in effect to subsection 113(5));

**D** is any portion of the relevant amount that can reasonably be considered to be excluded, reduced, offset or otherwise effectively sheltered from income or profits tax by reason of any exemption, exclusion, deduction, credit (other than a credit for tax payable under Part XIII) or other form of relief that

(a) applies specifically in respect of all or a portion of the relevant amount and not in computing the entity’s relevant foreign income or profits in general; or

(b) arises in respect of the payment;

**E** is the amount determined by the formula

$$(A - C - D) \times G/H$$

where

**G** is the total of all amounts, each of which is an amount that

(i) meets the following conditions:

(A) is repaid or repayable in respect of income or profits paid or payable by the entity to the government of a country other than Canada in respect of the relevant foreign income or profits for the year, and

(B) is not repaid or repayable because a loss is used to reduce or offset the relevant foreign income or profits for the year, or

(ii) is paid or payable in respect of a credit that can reasonably be considered to reduce or offset, directly or indirectly, the income or profits tax referred to in clause (i)(A), and

**H** is the total amount of the income or profits tax referred to in clause (i)(A) of the description of G; and

**F** is the amount determined by the formula

$$(A - C - D - E) \times (1 - I/J)$$

where

**I** is the rate at which the income or profits tax referred to in clause (i)(A) in the description of G is charged in respect of the relevant amount; and

**J** is the highest rate at which an income or profits tax imposed by the government of the country is charged in respect of an amount of income in respect of a financial instrument. (*revenu ordinaire étranger*)

**foreign taxation year** of an entity means the period for which the accounts of the entity have been ordinarily made up for the purpose of computing relevant foreign income or profits of the entity, but no such period may exceed 53 weeks. (*année d'imposition étrangère*)

**hybrid mismatch amount** in respect of a payment means

- (a) if the payment arises under a hybrid financial instrument arrangement, the amount of the hybrid financial instrument mismatch in respect of the payment;
- (b) if the payment arises under a hybrid transfer arrangement, the amount of the hybrid transfer mismatch in respect of the payment; or
- (c) if the payment arises under a substitute payment arrangement, the amount of the substitute payment mismatch in respect of the payment. (*montant de l'asymétrie hybride*)

**hybrid mismatch arrangement** under which a payment arises means

- (a) a hybrid financial instrument arrangement under which the payment arises;
- (b) a hybrid transfer arrangement under which the payment arises; or
- (c) a substitute payment arrangement under which the payment arises. (*dispositif hybride*)

**payer** of a payment includes any entity that has an obligation to pay, credit or confer, either immediately or in the future and either absolutely or contingently, the payment to an entity. (*payeur*)

**payment** includes any amount or benefit that any entity has an obligation to pay, credit or confer, either immediately or in the future and either absolutely or contingently, to an entity. (*paiement*)

**recipient** of a payment includes any entity that has an entitlement to be paid, credited or conferred, either immediately or in the future and either absolutely or contingently, the payment by an entity. (*bénéficiaire*)

**relevant foreign income or profits** of an entity means income or profits in respect of which the entity is subject to an income or profits tax that is imposed by the government of a country other than Canada. (*revenu ou bénéfices étrangers pertinents*)

**specified entity**, in respect of another entity at any time, means a particular entity if, taking into consideration the rules in subsection (17),

- (a) the particular entity at that time, either alone or together with entities with whom the particular entity does not deal at arm's length, owns directly or indirectly equity interests in the other entity that
  - (i) provide 25% or more of the votes that could be cast at an annual meeting of the shareholders, if the other entity is a corporation, or
  - (ii) have 25% or more of the fair market value of all equity interests in the other entity;
- (b) the condition in paragraph (a) would be satisfied if the references in that paragraph to "particular entity" were read as references to "other entity" and the references to "other entity" were read as references to "particular entity"; or
- (c) a third entity at that time, either alone or together with entities with which the third entity does not deal at arm's length, owns directly or indirectly equity interests in the particular entity and the other entity that, in respect of each of the particular entity and the other entity
  - (i) provide 25% or more of the votes that could be cast at an annual meeting of the shareholders, if the particular entity or the other entity, as the case may be, is a corporation, or

(ii) have 25% or more of the fair market value of all equity interests in the particular entity or the other entity, as the case may be. (*entité déterminée*)

**specified minimum tax regime** means

(a) any provisions in respect of global intangible low-taxed income, within the meaning of section 951A of the *Internal Revenue Code of 1986* of the United States, as amended from time to time;

(b) 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, in whole or in part, the *Global Anti-Base Erosion Model Rules* set out in *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 on December 20, 2021; or

(c) 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, in whole or in part, a “Qualified Domestic Minimum Top-up Tax” within the meaning of the model rules referred to in paragraph (b). (*régime fiscal minimum déterminé*)

**structured arrangement** means any transaction, or series of transactions, if

(a) the transaction or series includes a payment that gives rise to a deduction/non-inclusion mismatch; and

(b) it can reasonably be considered, having regard to all the facts and circumstances, including the terms or conditions of the transaction or series, that

(i) any economic benefit arising from the deduction/non-inclusion mismatch is reflected in the pricing of the transaction or series, or

(ii) the transaction or series was otherwise designed to, directly or indirectly, give rise to the deduction/non-inclusion mismatch. (*dispositif structuré*)

**transaction** includes an arrangement or event. (*opération*)

### Interpretation

(2) This section, section 12.7 and subsection 113(5) relate to the implementation of the *Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements* published by the Organisation for Economic Co-operation and Development on October 5, 2015 and, unless the context otherwise requires, are to be interpreted consistently with that report, as amended from time to time.

### Primary rule – conditions for application

(3) Subsection (4) applies in respect of a payment if

(a) in the absence of this section, subsection 18(4) and subsection 18.2(2), an amount would be deductible, in respect of the payment, in computing a taxpayer’s income from a business or property for a taxation year; and

(b) that amount is the deduction component of a hybrid mismatch arrangement under which the payment arises.

### Primary rule – consequences

(4) If this subsection applies in respect of a payment, notwithstanding any other provision of this Act, in computing a taxpayer’s income from a business or property for a taxation year, no deduction shall be made in respect of the payment to the extent of the hybrid mismatch amount in respect of the payment.

### **Structured arrangements — exception**

**(5)** If subsection (4) or 12.7(3) would, in the absence of this subsection, apply in respect of a payment in computing a taxpayer's income from a business or property for a taxation year, that subsection does not apply in respect of the payment if

**(a)** there would be no hybrid mismatch arrangement in respect of the payment if the payment did not arise under, or in connection with, a structured arrangement;

**(b)** at the time that the taxpayer entered into, or acquired an interest in any part of a transaction that is, or is part of, the structured arrangement, it was not reasonable to expect that any of the following entities were aware of the deduction/non-inclusion mismatch arising from the payment:

**(i)** the taxpayer,

**(ii)** an entity with which the taxpayer does not deal at arm's length, or

**(iii)** a specified entity in respect of the taxpayer; and

**(c)** none of the entities described in subparagraphs (b)(i) to (iii) shared in the value of any economic benefit resulting from the deduction/non-inclusion mismatch.

### **Deduction/non-inclusion mismatch — conditions**

**(6)** For the purposes of this section and section 12.7, a payment gives rise to a deduction/non-inclusion mismatch if

**(a)** the following condition is met:

$$A > B$$

where

**A** is the total of all amounts, each of which would, in the absence of this section, subsection 18(4) and subsection 18.2(2), be deductible in respect of the payment, in computing the income of a taxpayer from a business or property under this Part for a taxation year (referred to in this paragraph as the "relevant year"), and

**B** is the total of all amounts each of which, in respect of the payment,

**(i)** can reasonably be expected to be — and actually is — foreign ordinary income of an entity for a foreign taxation year that begins on or before the day that is 12 months after the end of the relevant year, or

**(ii)** is Canadian ordinary income of a taxpayer for a taxation year that begins on or before the day that is 12 months after the end of the relevant year, or

**(b)** the following condition is met:

$$C > D$$

where

**C** is the total of all amounts, each of which, in the absence of any foreign expense restriction rule, would be — or would reasonably be expected to be — deductible, in respect of the payment, in computing relevant foreign income or profits of an entity for a foreign taxation year (referred to in this paragraph as the "relevant foreign year"), and

**D** is the total of all amounts, each of which, in respect of the payment,

**(i)** would, in the absence of section 12.7, be Canadian ordinary income of a taxpayer for a taxation year that begins on or before the day that is 12 months after the end of the relevant foreign year, or

**(ii)** can reasonably be expected to be — and actually is — foreign ordinary income of another entity for a foreign taxation year that begins on or before the day that is 12 months after the end of the relevant foreign year.

### **Deduction/non-inclusion mismatch — application**

**(7)** For the purposes of this section and section 12.7, if a payment gives rise to a deduction/non-inclusion mismatch,

**(a)** the amount, if any, determined for A in paragraph (6)(a) in respect of the payment is the deduction component of the deduction/non-inclusion mismatch;

**(b)** the amount, if any, determined for C in paragraph (6)(b) in respect of the payment is the foreign deduction component of the deduction/non-inclusion mismatch; and

**(c)** the amount of the deduction/non-inclusion mismatch arising from the payment is determined by the formula

$$A - B$$

where

**A** is

**(i)** if paragraph (6)(a) applies in respect of the payment, the deduction component of the deduction/non-inclusion mismatch, or

**(ii)** if paragraph (6)(b) applies in respect of the payment, the foreign deduction component of the deduction/non-inclusion mismatch, and

**B** is

**(i)** if subparagraph (i) of the description of A applies,

**(A)** where the amount determined for B in paragraph (6)(a) in respect of the payment is equal to 10% or less of the amount determined for A, nil, and

**(B)** in any other case, the amount determined for B in paragraph (6)(a) in respect of the payment, or

**(ii)** if subparagraph (ii) of the description of A applies,

**(A)** where the amount determined for D in paragraph (6)(b) in respect of the payment is equal to 10% or less of the amount determined for A, nil, and

**(B)** in any other case, the amount determined for D in paragraph (6)(b) in respect of the payment.

#### **No double counting**

**(8)** Any amount that has already been included, directly or indirectly, in computing foreign ordinary income or Canadian ordinary income of a particular entity in respect of a payment shall not be included, directly or indirectly, in computing foreign ordinary income or Canadian ordinary income of the particular entity or any other entity in respect of the payment.

#### **Notional interest expense — deemed payment**

**(9)** For the purposes of this section (other than this subsection) and section 12.7, if, in the absence of any foreign expense restriction rule, an amount (referred to in this subsection as the “deductible amount”) would be, or can reasonably be expected to be, deductible by a debtor in respect of a notional interest expense on a debt in computing its relevant foreign income or profits for a foreign taxation year

**(a)** the debtor is deemed to make a payment in the year under the debt to the creditor in respect of the debt, in an amount equal to the deductible amount, and the creditor is deemed to be a recipient of such payment;

**(b)** the deductible amount is deemed to be in respect of the payment;

**(c)** any amount that is foreign ordinary income or Canadian ordinary income of the creditor in respect of notional interest income on the debt, that is calculated in respect of the same time period as the notional interest expense, is deemed to arise in respect of the deemed payment; and

**(d)** any deduction/non-inclusion mismatch arising from the payment is deemed to satisfy the condition in paragraph (10)(d).

### **Hybrid financial instrument arrangement – conditions**

**(10)** For the purposes of this section and section 12.7, a payment arises under a hybrid financial instrument arrangement if

- (a)** the payment (other than a payment described in paragraphs (14)(a) to (d)) arises under, or in connection with, a financial instrument;
- (b)** any of the following conditions is satisfied:
  - (i)** a payer of the payment does not deal at arm's length with, or is a specified entity in respect of, a recipient of the payment, or
  - (ii)** the payment arises under, or in connection with, a structured arrangement;
- (c)** the payment gives rise to a deduction/non-inclusion mismatch; and
- (d)** it can reasonably be considered that the deduction/non-inclusion mismatch
  - (i)** arises in whole or in part because of a difference in the treatment of the financial instrument – or of one or more transactions, either alone or together, where the transaction or transactions are part of a transaction or series of transactions that includes the payment or relates to the financial instrument – for tax purposes under the laws of more than one country that is attributable to the terms or conditions of the financial instrument or transaction or transactions, or
  - (ii)** would arise in whole or in part because of a difference described in subparagraph (i), if any other reason for the deduction/non-inclusion mismatch were disregarded.

### **Hybrid financial instrument arrangement – amount**

**(11)** For the purposes of this section and section 12.7, if a payment arises under a hybrid financial instrument arrangement,

- (a)** the amount of the hybrid financial instrument mismatch, in respect of the payment, is the portion of the amount of the deduction/non-inclusion mismatch arising from the payment that meets the condition in subparagraph (10)(d)(i) or (ii);
- (b)** the deduction component, if any, of the deduction/non-inclusion mismatch is the deduction component of the hybrid financial instrument arrangement in respect of the payment; and
- (c)** the foreign deduction component, if any, of the deduction/non-inclusion mismatch is the foreign deduction component of the hybrid financial instrument arrangement in respect of the payment.

### **Hybrid transfer arrangement – conditions**

**(12)** For the purposes of this section and section 12.7, a payment arises under a hybrid transfer arrangement if

- (a)** the payment arises under, or in connection with,
  - (i)** a transaction or series of transactions (referred to in this subsection as the “transfer arrangement”) that includes a disposition, loan or other transfer by an entity to another entity (referred to in this subsection as the “transferor” and “transferee”, respectively) of all or a portion of a financial instrument (referred to in this subsection as the “transferred instrument”), or
  - (ii)** the transferred instrument;
- (b)** any of the following conditions is satisfied:
  - (i)** at any time during the transfer arrangement

**(A)** a payer of the payment does not deal at arm's length with, or is a specified entity in respect of, a recipient of the payment, or

**(B)** the transferor does not deal at arm's length with, or is a specified entity in respect of, the transferee, or

**(ii)** the payment arises under, or in connection with, a structured arrangement;

**(c)** the payment gives rise to a deduction/non-inclusion mismatch; and

**(d)** it can reasonably be considered that the deduction/non-inclusion mismatch arises (or would arise, if any reason for the mismatch other than the reasons described in subparagraphs (i) and (ii) were disregarded), in whole or in part, because

**(i)** if the payment arises as compensation for a particular payment under the transferred instrument,

**(A)** the tax laws of one country treat all or a portion of the payment as though it has the same character as, or represents, the particular payment, in determining the tax consequences to an entity that is a recipient of the payment but not of the particular payment, and

**(B)** the tax laws of another country treat the payment as a deductible expense of another entity, or

**(ii)** in any other case,

**(A)** the tax laws of one country treat one or more transactions included in the transfer arrangement, either alone or together, as or as equivalent to a borrowing or other indebtedness, or treat all or a portion of the payment as arising under, or in connection with, a borrowing or other indebtedness, and the tax laws of another country do not treat the transaction or transactions, or the payment, as the case may be, in that manner, or

**(B)** the tax laws of one country treat the payment, or any other payment arising under or in connection with the transfer arrangement or transferred instrument, as though the payment or other payment was derived by one entity and the tax laws of another country treat the payment or other payment, as the case may be, as though it was derived by another entity, because of a difference in how the countries treat one or more transactions included in the transfer arrangement, either alone or together.

#### **Hybrid transfer arrangement — amount**

**(13)** For the purposes of this section and section 12.7, if a payment arises under a hybrid transfer arrangement,

**(a)** the amount of the hybrid transfer mismatch, in respect of the payment, is the portion of the amount of the deduction/non-inclusion mismatch arising from the payment that meets a condition in subparagraph (12)(d)(i) or (ii);

**(b)** the deduction component, if any, of the deduction/non-inclusion mismatch is the deduction component of the hybrid transfer arrangement in respect of the payment; and

**(c)** the foreign deduction component, if any, of the deduction/non-inclusion mismatch is the foreign deduction component of the hybrid transfer arrangement in respect of the payment.

#### **Substitute payment arrangement — conditions**

**(14)** For the purposes of this section and section 12.7, a payment arises under a substitute payment arrangement if

**(a)** the payment arises under, or in connection with, an arrangement under which all or a portion of a financial instrument is disposed of, loaned or otherwise transferred by an entity to another entity (referred to in this subsection as the “transferor” and “transferee”, respectively);

**(b)** the transferee, or an entity that does not deal at arm's length with the transferee, is a payer of the payment;

**(c)** the transferor, or an entity that does not deal at arm's length with the transferor, is a recipient of the payment;

**(d)** all or a portion of the payment can reasonably be considered to represent or otherwise reflect, or be determined by reference to

**(i)** another payment (referred to in this subsection and subsection (15) as the “underlying return”) that arises under, or in connection with, the financial instrument, or

**(ii)** revenue, profit, cash flow, commodity price or any other similar criterion;

**(e)** any of the following conditions is satisfied:

**(i)** at any time during that series of transactions that includes the arrangement,

**(A)** a payer of the payment does not deal at arm’s length with, or is a specified entity in respect of, a recipient of the payment, or

**(B)** the transferor does not deal at arm’s length with, or is a specified entity in respect of, the transferee, or

**(ii)** the payment arises under, or in connection with, a structured arrangement;

**(f)** the payment

**(i)** would give rise to a deduction/non-inclusion mismatch if any Canadian ordinary income of a taxpayer for a taxation year and any foreign ordinary income of an entity for a foreign taxation year, in respect of the payment, were limited to the portion of those amounts that can reasonably be considered to relate to the portion of the payment that is described in paragraph (d), or

**(ii)** if the condition in subparagraph (i) is not met, would meet the condition in that subparagraph if any amount that, in the absence of this section, subsection 18(4) or 18.2(2) or any foreign expense restriction rule, would be — or would reasonably be expected to be — deductible by the transferee in respect of the underlying return were instead considered to be deductible in respect of the payment, to the extent that the amount

**(A)** would be — or would reasonably be expected to be — deductible by the transferee in computing its income from a business or property for a taxation year or its relevant foreign income or profits for a foreign taxation year, as the case may be, and

**(B)** would be — or would reasonably be expected to be — so deductible because the underlying return accrued (or is considered to accrue) for a period before the transfer; and

**(g)** one of the following conditions is satisfied:

**(i)** the transferee or an entity that does not deal at arm’s length with the transferee is a recipient of the underlying return — or, if subparagraph (d)(ii) applies, a distribution under the financial instrument — and the amount of the underlying return or the distribution, as the case may be, exceeds the total of all amounts, in respect of the underlying return or the distribution, as the case may be, each of which can reasonably be expected to be — and actually is — foreign ordinary income for a foreign taxation year or Canadian ordinary income for a taxation year, as the case may be, of the recipient,

**(ii)** the condition in subparagraph (i) would be satisfied if the transferee were the recipient of the underlying return, or, if subparagraph (d)(ii) applies, a distribution under the financial instrument, or

**(iii)** if the transferor were the recipient of the underlying return, or, if subparagraph (d)(ii) applies, a distribution under the financial instrument,

**(A)** an amount in respect of the underlying return or distribution, as the case may be, would reasonably be expected to be foreign ordinary income for a foreign taxation year or Canadian ordinary income for a taxation year, as the case may be, of the transferor,

(B) the underlying return or distribution, as the case may be, would arise under a hybrid mismatch arrangement, or

(C) a foreign hybrid mismatch rule would reasonably be expected to apply in respect of the underlying return or distribution, as the case may be.

#### **Substitute payment arrangement — amount**

(15) For the purposes of this section and section 12.7, if a payment arises under a substitute payment arrangement,

(a) the amount of the substitute payment mismatch, in respect of the payment, is the lesser of

(i) the amount of the deduction/non-inclusion mismatch arising from the payment,

(A) if the condition in subparagraph (14)(f)(i) applies, determined based on the assumption in that subparagraph, or

(B) if the condition in subparagraph (14)(f)(ii) applies, determined based on the assumption in that subparagraph, and

(ii) the amount of the payment, or the portion of the payment, as the case may be, described in paragraph (14)(d);

(b) the deduction component, if any, of the deduction/non-inclusion mismatch is the deduction component of the substitute payment arrangement in respect of the payment;

(c) the foreign deduction component, if any, of the deduction/non-inclusion mismatch is the foreign deduction component of the substitute payment arrangement in respect of the payment; and

(d) if the condition in subparagraph (14)(f)(ii) is met in respect of the payment, any amount that, in the absence of this section, subsection 18(4) or 18.2(2) or any foreign expense restriction rule, would be — or would reasonably be expected to be — deductible by the transferee in respect of the underlying return that meets the conditions in clauses 14(f)(ii)(A) and (B) is deemed to be deductible by the transferee in respect of the payment for the purposes of applying subsections (3) and (4) and section 12.7.

#### **Substituted instruments**

(16) For the purposes of this section and section 12.7, any financial instrument that is substituted for a particular financial instrument is deemed to be the particular financial instrument.

#### **Specified entity — deeming rules**

(17) For the purposes of the definition *specified entity*, in determining the equity interests owned, directly or indirectly, by any entity (the “first entity”) in any other entity (the “second entity”) at any time, the following rules apply:

(a) the rights of the first entity and any entities with which it does not deal at arm’s length, that are rights referred to after paragraph (b) in the definition *specified shareholder* in subsection 18(5) or in paragraph (a) or (b) of the definition *specified beneficiary* in that subsection, or that are similar rights in respect of partnerships or any other entity, are deemed to be immediate and absolute and to have been exercised at that time; and

(b) paragraph (c) of the definition *specified beneficiary* in subsection 18(5) is deemed to apply at that time and the references in that definition to “particular person” are to be read as references to “first entity”.

#### **Tiered partnerships**

(18) For the purposes of this section and section 12.7, a person or partnership that is a member of a particular partnership that is a member of another partnership is deemed to be a member of the other partnership, and the person or partnership is deemed to have, directly, rights to the income or capital of the other partnership to the extent of the person or partnership’s direct and indirect rights to that income or capital.

### **Multiple recipients**

**(19)** For the purposes of this section and section 12.7, if there would, in the absence of this subsection, be multiple recipients of a particular payment, each portion of the particular payment that arises to each recipient is deemed to be a separate payment.

### **Anti-avoidance**

**(20)** The tax consequences (within the meaning of subsection 245(1)) to a person shall be determined in order to deny a tax benefit (within the meaning of subsection 245(1)) to the extent necessary to eliminate any deduction/non-inclusion mismatch, or other outcome that is substantially similar to a deduction/non-inclusion mismatch, arising from a payment if

**(a)** it can reasonably be considered that one of the main purposes of a transaction or series of transactions that includes the payment is to avoid or limit the application of subsection 12.7(3), 18.4(4) or 113(5) in respect of the payment; and

**(b)** any of the following conditions is met:

**(i)** the payment is a dividend and an amount would be — or would reasonably be expected to be — deductible in respect of the payment in computing relevant foreign income or profits of an entity for a foreign taxation year,

**(ii)** the mismatch or other outcome arises in whole or in part because of a difference in tax treatment of any transaction or series of transactions under the laws of more than one country that is attributable to the terms or conditions of the transaction or one or more transactions included in the series, or

**(iii)** the mismatch or other outcome would arise in whole or in part because of a difference described in subparagraph (ii), if any other reason for the mismatch or other outcome were disregarded.

**(2) Subsection (1) applies in respect of payments arising on or after July 1, 2022.**

**3 (1) The Act is amended by adding the following after paragraph 20(1)(xx):**

### **Adjustment for hybrid mismatch**

**(yy)** if subsection 18.4(4) has applied to deny a taxpayer a deduction, for the year or a preceding taxation year, for all or a portion of an amount in respect of a payment arising under a hybrid mismatch arrangement, and the taxpayer demonstrates that an amount is foreign ordinary income of an entity in respect of the payment (other than any amount of foreign ordinary income already taken into account in determining the amount of the deduction that was previously denied or a deduction under this paragraph) for a foreign taxation year that ends on or before the day that is 12 months after the end of the year

**(i)** the lesser of

**(A)** the amount by which the deduction that was denied exceeds the total of all amounts already deducted under this paragraph in respect of the payment for the year or any previous year, and

**(B)** the amount of the foreign ordinary income, and

**(ii)** the amount that is deductible under this paragraph is deemed to be deductible in respect of the payment.

**(2) Subsection (1) applies in respect of payments arising on or after July 1, 2022.**

**4 (1) Subsection 113(3) of the Act is amended by adding the following definitions in alphabetical order:**

**deductible**, in reference to an amount in respect of a payment, in computing relevant foreign income or profits, has the same meaning as in subsection 18.4(1). (*déductible*)

**entity** has the same meaning as in subsection 95(1). (*entité*)

**equity interest** has the same meaning as in subsection 18.4(1). (*participation*)

**foreign hybrid mismatch rule** has the same meaning as in subsection 18.4(1). (*règle étrangère d'asymétrie hybride*)

**foreign interest restriction rule** has the same meaning as in subsection 18.4(1). (*régle étrangère de restriction des dépenses*)

**foreign taxation year** of an entity has the same meaning as in subsection 18.4(1). (*année d'imposition étrangère*)

**relevant foreign income or profits** of an entity for a foreign taxation year has the same meaning as in subsection 18.4(1). (*revenu ou bénéfices étrangers pertinents*)

**(2) Section 113 of the Act is amended by adding the following after subsection (4):**

**Deduction restriction**

**(5)** Any amount that, in the absence of this subsection, would be a dividend received by a corporation resident in Canada on a share owned by it of the capital stock of a foreign affiliate of the corporation is deemed, for the purposes of this section (other than this subsection), not to be a dividend received by the corporation on a share of the capital stock of the affiliate to the extent of the total of all amounts, each of which, in respect of the dividend,

**(a)** is an amount that is or can reasonably be expected to be deductible in computing

**(i)** relevant foreign income or profits, for a foreign taxation year, of

**(A)** the affiliate, or

**(B)** another entity because that entity has a direct or indirect equity interest in the affiliate, or

**(ii)** income or profits of the affiliate that are taken into account in determining relevant foreign income or profits of another entity for a foreign taxation year; or

**(b)** would, in the absence of any foreign hybrid mismatch rule or foreign expense restriction rule, be described in paragraph (a).

**(3) Subsections (1) and (2) apply in respect of any dividend received by a corporation resident in Canada on a share owned by the corporation of the capital stock of a foreign affiliate of the corporation on or after July 1, 2022.**

**5 (1) The portion of subsection 214(17) of the Act before paragraph (a) is replaced by the following:**

**Deemed interest payments**

**(17)** For the purposes of subsections (16) and (18),

**(2) Section 214 of the Act is amended by adding the following after subsection (17):**

**Hybrid mismatch arrangements — deemed dividend**

**(18)** For the purposes of this Part, an amount paid or credited as interest by a corporation resident in Canada in a taxation year of the corporation to a non-resident person is deemed to have been paid by the corporation as a dividend, and not to have been paid or credited by the corporation as interest, to the extent that an amount in respect of the interest is not deductible in computing the income of the corporation for the year because of subsection 18.4(4).

**(3) Subsections (1) and (2) apply in respect of payments arising on or after July 1, 2022.**

