

# Cross-border takeaways from the 2021 Federal Budget

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Earlier this year, Finance Minister Chrystia Freeland tabled Budget 2021.

This budget is Minister Freeland's first as Finance Minister, as well as Canada's first since the COVID-19 pandemic began (you can read our general discussion of the 2021 Budget [here](#)).

Included in Budget 2021 were proposed new measures that specifically targeted taxpayers with a cross-border presence. Arguably, the two main cross-border proposals in Budget 2021 were the increased limitations on interest deductibility and the new rules addressing "hybrid mismatch arrangements".

## New limitations on interest deductibility

The proposal to limit the deductibility of interest seeks to incorporate into Canadian domestic law the recommendations set out in the OECD's BEPS Action 4 report. The deductibility of cross-border interest has long been subject to BEPS considerations, as (among other concerns) excessive interest expense can be incurred by Canadian businesses and paid to related non-residents in low-tax jurisdictions. While Canada's existing framework (including the thin capitalization rules) already targets these types of avoidance transactions and will remain in place, the proposal in Budget 2021 goes further.

When implemented, for taxation years beginning after 2022 and subject to certain exceptions (mainly applicable to Canadian corporate groups), interest, and certain equivalent-to-interest payments, may only be deducted by taxpayers subject to the rule up to a fixed ratio of such taxpayers' "tax EBITDA", a new concept that will generally be equal to taxable income before interest expense, interest income, income tax and depreciation/amortization.

## Hybrid mismatch arrangements

Consistent with the OECD's BEPS Action 2 report, Budget 2021 also proposes that over the next two years, measures will be introduced to deny tax benefits derived from certain cross-border tax avoidance structures referred to as "hybrid mismatch arrangements" (and "branch mismatch arrangements"). These are generally transactions that exploit non-reciprocal treatment relating to certain cross-border payments.

The two primary examples of hybrid mismatch arrangements arise in cases where one country allows a cross-border payment to be deducted from the payor's income, but there is no corresponding inclusion in the recipient's income (within a reasonable period of time), and in cases where a hybrid structure allows for the same economic expense to

be deducted more than once because the same deduction is available in different countries. The Government also intends to introduce rules addressing other forms of mismatch arrangements “to the extent relevant and appropriate”.