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## Treaty Shopping and the New Multilateral Tax Agreement—Is it Business as Usual in Canada?

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Treaty Shopping and the New  
Multilateral Tax Agreement—Is it  
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*On 1 January 2020 the Organization for Economic Cooperation and Development's (OECD) Multilateral Convention (MLI) entered into effect for many of Canada's tax treaties. New provisions introduced by the MLI, specifically the principal purpose test (PPT) and a new preamble, raised concerns that the bar to deny treaty benefits would be substantially lower than the bar previously set by Canada's General Anti-Avoidance Rule (GAAR). This paper considers how the MLI will impact access to treaty benefits in Canada by applying the new MLI measures to treaty shopping cases previously challenged under the GAAR. The paper concludes that application of the PPT by Canadian courts will result in similar outcomes in these cases. In short, the MLI will arrive 'with a whimper and not a bang' in Canada. The MLI's most significant impact on Canadian international tax law will be the patchwork quilt of tax avoidance regimes that will govern Canada's tax treaties in the future.*

*La Convention multilatérale (IM) , née de l'Initiative de l'OCDE e vue de prévenir l'érosion de la base d'imposition et le transfert des bénéfices (BEPS) et lutter contre l'évasion fiscale internationale, est entrée en vigueur au Canada le 1er décembre 2019. L'IM entraînera des modifications à de nombreuses conventions fiscales du Canada, notamment l'ajout de nouvelles mesures pour contrer les stratégies d'évitement fiscal. Il est généralement admis que ces mesures abaisseront considérablement la barre pour éliminer les avantages des conventions fiscales qui avait été fixée par la règle générale anti-évitement (RGAE) du Canada, et remettront en question le statu quo selon lequel, à des fins fiscales, le « chalandage fiscal » n'est pas en soi « intrinsèquement correct ou incorrect ». Le présent article remet en question cette conclusion. Le principal changement qui sera apporté par l'IM aux 93 conventions fiscales du Canada consistera en une série de régimes d'évitement fiscal différents selon qu'il s'agit d'une convention couverte ou non et selon les mesures d'évitement fiscal spécifiques qu'elle adopte.*

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*Introduction*

The Multilateral Convention (MLI),<sup>1</sup> born out of the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting Initiative (BEPS) to combat international tax avoidance, entered into force in Canada on 1 December 2019.<sup>2</sup> The MLI changes many of Canada's tax treaties by adding new measures to counter tax avoidance strategies.<sup>3</sup> It is widely thought that these measures will substantially lower the bar to deny tax treaty benefits that had been set by Canada's

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1. OECD, Committee on Fiscal Affairs, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Paris: OECD, 2016).

2. Canada, Department of Foreign Affairs Trade and Development, *Status of List of Reservations and Notifications at the Time of Signature* (Ottawa: Foreign Affairs Trade and Development, 30 May 2017) [*List of Reservations*].

3. Canada, Parliament, *Debates of the Senate*, 42-1, vol 150, No 286 (9 May 2019) at 8062.

general anti-avoidance rule (GAAR) and challenge the status quo that, for tax purposes, ‘treaty shopping’ is not in and of itself “inherently proper or improper.”<sup>4</sup>

In this paper we beg to differ. In the absence of a clear international meaning or interpretive principles, the new minimum standard introduced by the MLI will achieve the same results in a pre- and post-MLI regime in Canada in most treaty shopping arrangements. The main change that will be introduced to Canada’s 93 tax treaties by the MLI will be an array of different tax avoidance regimes depending on whether the treaty is a covered agreement<sup>5</sup> and the specific tax avoidance measures it adopts. The paper is divided into two parts. Part I provides a brief overview of the key components in the tax avoidance regime in Canada in the post-MLI regime. Part II explores the potential impact of the MLI in three hypotheticals. Two are based on past treaty cases that were unsuccessfully challenged by the Canada Revenue Agency (CRA).<sup>6</sup> The third considers the future of double-dip financing structures under Canada’s covered agreements. Part III offers some conclusions.

### I. *The legal landscape*

One of the primary goals of the MLI is to prevent treaty abuse, including treaty shopping. Treaty shopping generally refers to tax arrangements designed to access treaty benefits that are not available directly.<sup>7</sup> It occurs when the taxpayer is not entitled to the benefits of a tax treaty but can make use of another juristic person, for example an intervening holding company, to obtain those benefits.

Under current Canadian law, treaty shopping in and of itself is not considered to be inherently improper or abusive.<sup>8</sup> To qualify as abusive, the

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4. *MIL (Investments) SA v Canada*, 2006 TCC 460 at para 72, TCJ No 362 [*MIL Investments*].

5. Covered tax agreements are those treaties each country lists in their Status of List of Reservations and Notifications to the OECD to which the MLI will apply. Instead of changing each individual agreement, the MLI lives beside the treaties and adjusts elements to certain minimum standards. 84 of Canada’s 93 tax treaties are listed in Canada’s notification to the OECD to which the minimum standard will apply. See Appendix A for a table of Canada’s listed covered agreements.

6. *MIL Investments*, *supra* note 4; *Prévost Car Inc v Canada*, 2008 TCC 231 [*Prévost Car*].

7. *Alta Energy Luxembourg SARL v Canada*, 2018 TCC 152, TCJ No 124 [*Alta Energy*] at para 92 the Court highlighted the OECD Glossary of Tax Terms definition: “An analysis of tax treaty provisions to structure an international transaction or operation so as to take advantage of a particular tax treaty.” The decision of the Tax Court was affirmed by the Federal Court of Appeal in *Alta Energy Luxembourg SARL v Canada*, 2020 FCA 43, FCJ No 204 [*Alta Energy FCA*].

8. In *Crown Forest*, the SCC stated in obiter that there is nothing improper if a taxpayer actively seeks to limit their tax liability by selecting international tax regimes most beneficial to them, see *Crown Forest Industries Ltd v Canada* [1995] 2 SCR 802 at paras 49 and 50. This view, that there is nothing inherently proper or improper about treaty shopping was repeated in *MIL Investments*, *supra* note 4. Most recently, the Federal Court of Appeal further clarified that it is how a treaty is used that must be examined to determine whether the transaction is abusive, see *Alta Energy FCA*, *supra* note 7

transaction or series would have to achieve an outcome that the provision was intended to prevent, defeat the underlying rationale of the provision, and/or circumvent the provision in a manner that frustrates or defeats its object, spirit or purpose.<sup>9</sup>

The primary tool to fight treaty shopping in Canada currently is the GAAR. A key factor in applying the GAAR to deny a benefit is that the benefit would result directly or indirectly in an abuse having regard to those provisions relied upon by the taxpayer.<sup>10</sup> This requires the court to go behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer.

While the GAAR gives wide discretion to the CRA to challenge the decisions of a taxpayer, the Supreme Court has stated that the use of the words “abuse and misuse” should not be understood as “implying moral opprobrium regarding the actions of a taxpayer to minimize tax liability... taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability.” The Supreme Court has also stated that the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear.<sup>11</sup>

To date, the Minister has suffered an unbroken line of defeats in applying the GAAR in a treaty shopping context. It is now generally accepted in Canada that a vague general policy against ‘treaty shopping’ cannot support a GAAR based finding of treaty abuse.<sup>12</sup> As discussed further below the MLI introduces a new anti-avoidance provision that many anticipate will substantially lower the bar set by the GAAR to deny treaty benefits.

### 1. *The MLI*

The MLI will apply to each country’s “covered tax agreements.” As a signatory to the MLI, Canada has agreed to include the proposed minimum standards among other measures, which include a new preamble that specifically references treaty-shopping arrangements, and to introduce a

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at para 78 quoting the Tax Court in *MIL Investments*.

9. *Cophorne Holdings Ltd v Canada*, 2011 SCC 63, 3 SCR 721 at para 72 [*Cophorne*].

10. The GAAR has been interpreted by the Supreme Court as “a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer. While the taxpayer’s transactions will be in strict compliance with the text of the relevant provisions relied upon, they may not necessarily be in accord with their object, spirit or purpose. In such cases, the GAAR may be invoked by the Minister.” See *Cophorne*, *supra* note 9 at para 66.

11. *Ibid* at para 68, quoting their previous decision in *Trustco*.

12. Although it is now arguable that the anti-avoidance measures introduced by the MLI could alter the abuse/misuse analysis under the Canadian GAAR. In our view it is unlikely this will be the case.

principal purpose test (the PPT) to deny a benefit under the treaty unless the benefit is in line with the object and purpose of the treaty.<sup>13</sup>

There is controversy about the legal effect of the change to the preamble of Canada's tax treaties. The *Vienna Convention* explicitly mandates that the context or the purpose of the interpretation of a treaty shall comprise the whole of the treaty including the preamble.<sup>14</sup> This is also the OECD's position on the interpretation of tax treaties, but this view has been challenged by numerous courts in Canada and in other jurisdictions.<sup>15</sup> While it may be arguable the new preamble may influence the GAAR analysis, the GAAR will be rendered largely redundant in Canadian covered agreements and supplanted by the PPT or detailed limitation on benefit provisions (DLOB).

The potentially significant change to Canada's covered tax agreements is the introduction of the PPT, which provides as follows:

Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.<sup>16</sup>

The PPT appears to introduce a much lower bar than the GAAR to deny a treaty benefit.<sup>17</sup> However this will depend largely on how Canadian courts apply the new test. There is no definition of the PPT in the treaty, nor international understanding about how the PPT is to be interpreted. As one

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13. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, 24 November 2016, OECD art 6 [MLI]. The preamble of covered tax agreements will be modified to include the following language: "Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)."

14. *Vienna Convention on the Law of Treaties* (with Annex), 23 May 1969, No 18232 art 31(2).

15. This was explicitly addressed in *MIL Investments*, where the Minister unsuccessfully attempted to use the preamble to the Canada–Luxembourg Treaty as an anti-abuse provision. See also Claire Peng and Josef Schuch, "The Relevance of the Preamble for Treaty Entitlements," *Tax Treaty Entitlement* (Vienna: IBFD, 2019) 1 at 8-11 [*Relevance of the Preamble*] who state, "the usefulness of preambles is limited no matter how well drafted because its interpretation is limited to substantive provisions."

16. MLI, *supra* note 13 at art 7(1).

17. Under the GAAR, the CRA must demonstrate abusive avoidance. Under the PPT, the CRA must demonstrate only that "one of the principal purposes of an arrangement or transaction was to achieve a tax benefit." It is then up to the taxpayer to establish that granting the benefit is in line with the object and purpose of the relevant treaty provision.

EU scholar recently noted, EU courts will take the OECD commentary into consideration, but they will also “create their own world” based on recent case law.<sup>18</sup> In the end, however, the test is whether the transaction or arrangement is in accordance with the object and purposes of the relevant provision(s), a test that is very familiar in Canadian tax jurisprudence. Because there is no definition in the treaty, each country, including Canada, may turn to its domestic law to determine the meaning of the language used in the PPT.<sup>19</sup>

The introduction of the PPT into Canada’s covered agreements is an interim measure. The Canadian government has noted that it intends to adopt DLOB provisions to replace or supplement the PPT through negotiations with treaty partners.<sup>20</sup> To date only Canada’s treaty with the United States includes a DLOB provision.<sup>21</sup> In effect, that DLOB provision denies treaty benefits to a non-qualifying person, thus providing a direct route to the denial of treaty benefits.<sup>22</sup>

The MLI came into effect for many of Canada’s covered agreements on 1 January 2020. It is important to understand how it will impact Canada’s current tax avoidance regime. In essence, different tax avoidance rules will apply depending on the other country involved. Countries included under Canada’s covered agreements will be subject to the new avoidance regime under the MLI.<sup>23</sup> Countries with non-covered tax treaties will remain subject to existing tax treaty rules. All countries, including those with which Canada does not have a tax treaty will remain subject to Canada’s domestic rules including the GAAR.

Canada’s arsenal to combat tax avoidance will therefore include specific domestic anti-avoidance rules and the GAAR, specific and general treaty anti-avoidance rules, and if the treaty is a covered agreement, the PPT. These provisions are discussed further below.

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18. Prof. Dr. Dennis Webber, University of Amsterdam, De Universiteit Van Amsterdam “The PPT and the EU abuse doctrine” (PowerPoint delivered at the Amsterdam Centre for Tax Law full day conference, 3 May 2019) [unpublished] slides 134-159.

19. OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, (OECD Publishing 2017) at art 3 [OECD Model].

20. *List of Reservations*, *supra* note 2 at 16.

21. *Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital*, United States and Canada, 26 September 1980, at art XXIX A [Canada-US Treaty].

22. *Ibid* at art XXIX A (2): qualifying persons include a natural person, Government or its political subdivisions, public companies, private companies and trusts with specific ownership qualifications, estates, non-profits with qualifications, and exempt organizations in art XXI.

23. See Appendix A.

## 2. *Canada's tax avoidance provisions*

In addition to the GAAR, there are several SAARS, or specific anti-avoidance rules in the *Income Tax Act (ITA)*.<sup>24</sup> These include transfer pricing, surplus stripping, thin capitalization and back-to-back arrangement rules, as well as the foreign affiliate regime. These rules supersede the GAAR in application.<sup>25</sup> It is likely that the new PPT test will apply after the application of domestic rules, but it is not precluded from superseding them.<sup>26</sup>

Many of Canada's treaties also contain specific anti-avoidance rules to deny treaty benefits. The MLI may alter these specific rules in covered agreements. However, non-covered agreements, including the tax treaty with the United States will not be impacted and will remain subject to their own unique rules.

While Canada has traditionally opted not to include DLOB provisions in its tax treaties, it has included what have been referred to as modified limitations on benefits provisions (MLOB)<sup>27</sup> in 14 of its existing treaties.<sup>28</sup> The current provisions in 13 of these treaties will be modified by the MLI and replaced with the PPT. This should have little practical effect on the outcome in treaty shopping cases given the similarity of the PPT to the prior provisions.<sup>29</sup>

Of Canada's 93 existing tax treaties, 43 also contain a specific anti-conduit provision.<sup>30</sup> This provision effectively denies a treaty benefit

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24. *Income Tax Act*, RSC 1985, c 1 (5th Supp) [*Act*].

25. Jinyan Li & Arthur Cockfield, *International Taxation in Canada*, 4th Ed (Toronto: Lexis Nexis) at 388. The GAAR is a rule of last resort for the competent authorities and should only apply in the absence or failure of a SAAR.

26. David G Duff, "International Tax Planning" (2018) 66:4 Canadian Tax J 947-1011 at 960 [International Tax Planning]. As noted by Duff, the purpose of domestic rules is to characterize transactions or arrangements and so they are likely to apply before the PPT. But authorities do not necessarily have to rely on domestic anti-avoidance rules. This could allow for situations where the PPT applies before specific ITA anti-avoidance rules.

27. MLOB provisions deny access to articles of tax treaties where the main purpose or one of the main purposes was to take advantage of the treaty article. It is generally worded as: "the provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment."

28. Chile, Colombia, Estonia, Hong Kong, Israel, Kazakhstan, Latvia, Lithuania, Mexico, New Zealand, Poland, Taiwan, Ukraine, and the United Kingdom.

29. While there are slight variations between the MLOB rules in each treaty, the core rule is the same. The provision effectively denies treaty withholding rates on dividends, interest, and royalties where one of the main purposes of a person is to obtain benefits under the treaty.

30. Algeria, Argentina, Armenia, Azerbaijan, Colombia, Croatia, Ecuador, Finland, Germany, Greece, Guyana, Hong Kong, Iceland, Indonesia, Ireland, Italy, Jordan, Kazakhstan, Kyrgyzstan, Malta, Mexico, Moldova, Mongolia, Nigeria, Norway, Oman, Peru, Poland, Republic of the Ivory Coast, Romania, Serbia, Slovak Republic, Slovenia, South Korea, Spain, Taiwan, Tanzania, Trinidad and Tobago, Turkey, Uzbekistan, Venezuela, Vietnam, Zimbabwe.



where an entity is a resident of a territory, but its beneficial owner is a non-resident and the entity is subject to a lower tax rate than similar entities with resident owners.<sup>31</sup>

Canada has not notified the OECD of the provisions, nor listed the treaties containing the provision. Whether the treaty is a covered tax agreement under the MLI or a non-covered treaty, the provision will therefore remain in force and effect. As the more specific rule, this provision is most likely to be applied before the PPT to deny a benefit in covered tax agreements.

Finally, there is the question of a general anti-avoidance provision in a tax treaty. The only non-covered agreement with Canada that contains a general anti-avoidance rule as a distinct provision is the tax treaty with Germany.<sup>32</sup> As discussed, the MLI will add the PPT as a general anti-avoidance rule to all of Canada's covered agreements once it is ratified.

### 3. *The future*

Over the next decade, Canada may have up to five different tax avoidance regimes governing its tax treaties and a sixth governing transactions with non-treaty countries. In all cases, domestic specific anti-avoidance rules will apply to the extent they do not conflict with treaty rules. As Canada embraces the PPT, it will likely act as a broad general anti-avoidance provision where specific ITA rules, treaty specific rules, and the GAAR fail to achieve the desired result. It has also been suggested that the CRA may skip application of the GAAR and use the PPT as their primary challenger.<sup>33</sup>

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31. *Arrangement Between the Canadian Trade Office in Taipei and the Taipei Economic and Cultural Office in Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, Canada and Taiwan, 15 January 2016, at art 26(3): "The Arrangement will not apply to any company, trust or other entity that is a resident of a territory and is beneficially owned or controlled, directly or indirectly, by one or more persons who are not residents of that territory, if the amount of the tax imposed on the income of the company, trust or other entity by the government of that territory is substantially lower than the amount that would be imposed by the government of that territory (after taking into account any reduction or offset of the amount of tax in any manner, including a refund, reimbursement, contribution, credit, or allowance to the company, trust or partnership, or to any other person) if all of the shares of the capital stock of the company or all of the interests in the trust or other entity, as the case may be, were beneficially owned by one or more individuals who were residents of that territory."

32. Art 29(6) of the treaty provides "nothing in the Agreement shall be construed as preventing a Contracting State from denying benefits under the Agreement where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of the Agreement or of the domestic laws of that State." Canada and Germany have been in negotiations since June of 2017. It is expected that the treaty will become a covered tax agreement when negotiations are complete, and a new treaty has been ratified. It remains to be seen if the general anti-avoidance provision will be carried over into the new agreement.

33. International Tax Planning, *supra* note 26 at 960.

**Table 1: Rule Order of Application in the Canadian Treaties**

Type of Treaty	Rule Order of Application
Covered MLI Agreements (PPT)	<ol style="list-style-type: none"> <li>1. Domestic Specific Rules</li> <li>2. Tax Treaty Provisions (including beneficial ownership and the PPT)</li> <li>3. GAAR</li> </ol>
Covered MLI Agreements (Limitation on Benefits (LOB))	<ol style="list-style-type: none"> <li>1. Domestic Specific Rules</li> <li>2. LOB</li> <li>3. GAAR</li> </ol>
Covered MLI Agreements (LOB and PPT)	<ol style="list-style-type: none"> <li>1. Domestic Specific Rules</li> <li>2. LOB</li> <li>3. PPT</li> <li>4. GAAR</li> </ol>
Canada–US Tax Treaty	<ol style="list-style-type: none"> <li>1. Domestic Specific Rules</li> <li>2. Article XXIX A (DLOB)</li> <li>3. Canada: GAAR / US: Substance over form</li> </ol>
Non-MLI Treaties	<ol style="list-style-type: none"> <li>1. Domestic Specific Rules</li> <li>2. Tax Treaty Provisions (including beneficial ownership and LOB if applicable)</li> <li>3. GAAR</li> </ol>
No Tax Treaty	<ol style="list-style-type: none"> <li>1. Domestic Rules</li> <li>2. GAAR (if possible)</li> </ol>

When DLOB provisions are negotiated into Canada’s treaties this is likely to change the treaties once more. The covered agreements will look more like Canada’s treaty with the United States where tax treaty benefits will be subject to a detailed uniform standard less reliant on general anti-avoidance rules. Canada’s non-MLI treaties will remain subject to the current regime relying on domestic rules and specific anti-avoidance provisions in the tax treaty, and non-treaty countries will remain subject to specific domestic rules and the GAAR.

*II: Application of Canada’s anti-avoidance provisions*

In order to demonstrate Canada’s anti-avoidance rules in operation, this section of the paper explores the application of the existing and the new MLI regime in three hypotheticals. The hypotheticals are examined from the Canadian perspective. It may also be necessary to consider the transaction(s) from the perspective of the other treaty partner and to consider whether the tax regime in the tax partner’s country includes a

specific or general anti-avoidance rule that would apply to the proposed arrangement.<sup>34</sup>

### 1. *Hypothetical 1*

Hypothetical 1 is loosely based on the facts in *MIL Investments*,<sup>35</sup> one of the first tax treaty decisions challenged under the Canadian GAAR. The facts and the Court's reasoning provide a useful framework to examine the potential outcome under current Canadian law and the MLI.

In *MIL Investments*, the taxpayer (MIL) was incorporated in the Cayman Islands by a non-resident shareholder.<sup>36</sup> Following a series of transactions including the sale of a small percentage of its holdings in Canco (a Canadian corporation), MIL migrated from the Caymans to Luxembourg.<sup>37</sup> Shortly thereafter, MIL tendered its remaining Canco shares to Inco (the final sale) and realized a \$426 million gain. At the time of this transaction, the shares were considered taxable Canadian property. However, under the Canada-Luxembourg Treaty, gains from the sale of a Canco's shares by a Luxembourg resident were taxable in Canada only if the shares were part of a substantial interest in the Canco.<sup>38</sup> At the time of

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34. Since *Prevost Car* was decided, the EU has brought ATAD, or the EU Anti-Avoidance doctrine, into effect. This has the potential to influence their approach to the interpretation of the treaty provisions and application of the PPT.

35. *MIL Investments*, *supra* note 4.

36. Non-treaty jurisdictions like the Cayman Islands were popular for tax planning due to their favorable tax regimes. There is growing evidence that this trend may soon end. New domestic rules in the Cayman Islands require that businesses maintain a degree of physical presence. Under pressure from the British Government and the European Union the Cayman Islands enacted an Economic Substance Law effective 1 January 2019 requiring companies operating in the Cayman Islands to maintain "a level of operational substance that is effectively commensurate with the income generating activities of that company." The Cayman Government has mandated an annual reporting obligation as of 2020 requiring companies to report their compliance with the new rules, see Bonn Liu et al, "New Cayman Islands Economic Substance Law is a Potential Game Changer for International Business" KPMG, Insights (19 March 2019), online: *KPMG Insights* <<https://home.kpmg/cn/en/home/insights/2019/03/new-cayman-islands-economic-substance-law.html>> [<https://perma.cc/QZ3A-QAC3>]. Also of note, the British Crown Dependencies of Guernsey, Mann, and Jersey signed the MLI on 7 June 2017, and it came into force regarding their handful of covered tax agreements between June and 1 July 2019. See OECD, *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, Status as of 9 April 2019, at 2-3.

37. Originally, MIL owned 11.9% and Mr. B about 0.5% of the shares of Diamond Field Resources Ltd. (Canco), a Canadian public corporation. In June 1995, MIL rolled 2.6% of its Canco shares to Inco Limited, another Canadian public corporation, for Inco shares. This reduced MIL's direct holding in Canco to about 9.3% (9.8% combined with Mr. B's holding). A month later, MIL migrated from the Caymans to Luxembourg, and the following month disposed of its Inco shares claiming a treaty exemption.

38. A substantial interest was 10 percent or more. MIL, a Luxembourg resident who directly owned less than 10% of the Canco shares when they were tendered to Inco for the final sale; claimed the treaty exemption, see *Convention Between the Government of Canada and the Government of the Grand Duchy of Luxembourg*, Canada and Luxembourg, 10 September 1999, at art 13(4)(a).

the final sale MIL no longer held a substantial interest under the treaty and claimed the treaty exemption.

The Tax Court held that the final sale was not part of the series and that none of the transactions, including the final sale were avoidance transactions.<sup>39</sup> Therefore, there was no need to analyze whether any of the transactions were abusive. On appeal, MIL admitted that its continuance as a Luxembourg corporation was an avoidance transaction. As a result, the tax benefit that MIL ultimately obtained was subject to the GAAR if the sale was part of the series of transactions or was undertaken in contemplation of the series of transactions and there was abuse. The Federal Court of Appeal found no support for the CRA's argument that the tax benefit obtained by MIL was an abuse or misuse of the object and purpose of the treaty or the *ITA*.

For purposes of the hypothetical discussion, assume a non-resident taxpayer (NRT) transfers shares that are taxable Canadian property to a holding company (Holdco) in the Cayman Islands.<sup>40</sup> Within the same year, Holdco agrees to exchange a portion of its shares for those of a third party on a rollover basis, lowering its holdings in Canco. Months later, Holdco is continued to Country X. The shareholders of Canco, including Holdco, vote to allow the third party to acquire Canco. Holdco realizes a significant capital gain of \$500 million (CAD) on the disposition of the Canco shares. In the discussion that follows, Country X is respectively a non-treaty country, a country with a non-covered treaty, and a country with a covered treaty under the MLI.

### 1. *Non-treaty country*

A non-resident is liable to tax on the disposition of taxable Canadian property.<sup>41</sup> Although listed on a designated stock exchange, the Canco

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39. *MIL Investments*, *supra* note 4 at paras 69 and 70.

40. *Act*, *supra* note 24 at s 248(1) "taxable Canadian property."

41. *Act*, *supra* note 24 at ss 2(3)(c) and 248(1) "taxable Canadian property" of a taxpayer at any time in a taxation year means a property of the taxpayer that is (e) a share of the capital stock of a corporation that is listed on a designated stock exchange, a share of the capital stock of a mutual fund corporation or a unit of a mutual fund trust, if, at any particular time during the 60-month period that ends at that time,

- (i) 25% or more of the issued shares of any class of the capital stock of the corporation, or 25% or more of the issued units of the trust, as the case may be, were owned by or belonged to one or any combination of
  - (A) the taxpayer,
  - (B) persons with whom the taxpayer did not deal at arm's length, and
  - (C) partnerships in which the taxpayer or a person referred to in clause (B) holds a membership interest directly or indirectly through one or more partnerships, and
- (ii) more than 50% of the fair market value of the share or unit, as the case may be, was derived directly or indirectly from one or any combination of properties described under

shares are taxable Canadian property if Holdco holds 25% or more of the issued shares (of any class) of Canco, and greater than 50% of the value of the shares is derived directly or indirectly from real or immovable property within a five-year period. Assume Holdco holds 29% of shares in Canco, and a year later this is reduced to 20%. The shares remain taxable Canadian property and any gain is taxable in Canada. Unlike the facts in *MIL Investments*, there is no applicable tax treaty that would exempt the gain from tax in Canada. Therefore, there would be no need for the CRA to resort to the GAAR.

If Holdco's ownership in Canco remained below 25% for a five-year period, the gain on the disposition of the Canco shares would be exempt in Canada.<sup>42</sup> The tax benefit, (no taxation), was explicitly allowed by parliament when they redefined taxable Canadian property in 2010 to promote greater investment into Canada.<sup>43</sup> Thus a reduction in share ownership to meet the exemption is in-line with the object, spirit, and purpose of the provision. Without abuse of a provision of the *ITA*, the GAAR is ineffective and the benefit would be allowed.

## 2. *Non-covered treaties*<sup>44</sup>

Under a non-covered agreement, additional analysis is required to determine if a gain that is taxable under Canadian domestic law is exempt as "treaty protected property."

Canada's nine non-covered tax agreements<sup>45</sup> will not be affected by the MLI and will continue to operate under their existing rules.<sup>46</sup> The application of Canada's anti-avoidance regime under these agreements would generally proceed in the following order<sup>47</sup>:

1. Are there any domestic specific *ITA* rules that apply?
2. Does the GAAR apply to the domestic provisions?<sup>48</sup>

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subparagraphs (d)(i) to (iv) (real or immovable property situated in Canada, Canadian resource properties, timber resource properties, and options or interests in property whether or not the property exists).

42. Under the *ITA*, when the taxpayer holds under 25% of public shares, they are not considered taxable Canadian property. If we reconsider the hypothetical and Holdco's holding remains 20% for at least 60 months and then the disposition is made, the sale would then be exempt.

43. *International Tax Planning, supra* at note 26 at 198.

44. See Appendix A: Table 2 for a list of Canada's non-covered agreements.

45. Those not listed by Canada who are signatories of the MLI, or those who are not signatories to the MLI.

46. This list includes Germany and Switzerland. Canada is in negotiations with Germany and Switzerland, and it is likely these treaties will become MLI covered agreements when negotiations are complete.

47. Using Canadian legislative interpretation principles, domestic provisions will likely apply before international ones and utilizing paramountcy, specific provisions will apply before general principles (*generalia specialibus non derogant*).

48. In *RMM Canadian Enterprises Inc v The Queen*, 1997 CarswellNat 400, 97 DTC 203 (TCC),

3. Is there a specific anti-avoidance rule in the treaty?
4. Is there a general anti-avoidance rule in the treaty?
5. Does the GAAR apply?

Assuming the shares continue to meet the definition of taxable Canadian property at the time of disposition by the non-resident, the gain will remain taxable in Canada under four of the nine non-covered agreements.<sup>49</sup> In the treaties with Germany, Switzerland, Venezuela, Uzbekistan, and Kyrgyzstan, however, any gain on shares will be exempt from Canadian tax under the specific wording of the treaties if shares are listed on an approved stock exchange.<sup>50</sup>

Notwithstanding a specific treaty exemption, the gain under any of these treaties may remain taxable in Canada as the result of a specific avoidance rule in the tax treaty. For example, the anti-conduit rules in the treaties with Uzbekistan, Venezuela, and Kyrgyzstan may apply to deny treaty benefits. The treaty with Germany also includes a general anti-abuse rule that could be used to deny treaty benefits.<sup>51</sup> Finally, in appropriate circumstances, the CRA might consider the GAAR.<sup>52</sup>

Assume as in *MIL* that the continuance into any of the seven treaty countries by Holdco was an admitted avoidance transaction undertaken to benefit from the treaty exemption.<sup>53</sup> Does it constitute an abuse of the treaty? Based on Canadian case law to date the answer remains no and the treaty exemption would not be denied by Canadian courts. As stated in *MIL*, the selection of a treaty to minimize tax is not abusive on its own, as what matters is the use of the treaty.<sup>54</sup>

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the Tax Court held that that Minister's assessment was sustainable under ss 84 and 212 of the *ITA*, in addition to being sustainable under the GAAR but application of the GAAR was unneeded in the circumstance.

49. Canada would have full authority to tax in the Ecuador, Taiwan, and the United States. The Canada–Guyana Treaty does not contain an article addressing capital gains in which case there may be a danger of double taxation.

50. *Agreement Between Canada and the Federal Republic of Germany for the Avoidance of Double Taxation with respect to Taxes on Income and Certain Other Taxes*, Canada and Germany, 19 April 2001, at art 13(4): “gains derived by a resident of a Contracting State from the alienation of (a) shares (other than shares listed on an approved stock exchange in the other Contracting State).”

51. Under the treaty with Germany, Canada can rely on a treaty based anti-avoidance rule to deny a benefit. Art 29(6) states, nothing in the agreement can be construed as preventing the states from denying benefits where it can reasonably be concluded that there would be an abuse of the provision or domestic law. The provision has yet to be used in a Canadian context, so its practical effect is unknown. Given its broad wording, it is a tool that no doubt will be well utilized if treaty abuse is suspected.

52. For example, if there is a no-tax scenario (likely Switzerland) or a loss consolidation regime that could lead to a reduction or no taxed paid.

53. *MIL (Investments) SA v Canada*, 2007 FCA 236, FCJ No 885 [*MIL Investments FCA*].

54. *MIL Investments*, *supra* note 4 at para 72.

#### 4. *MLI-covered agreements*

As of 1 January 2020, Canada's active covered agreements<sup>55</sup> include the OECD's minimum standard including the PPT and the new preamble that specifically references treaty-shopping arrangements.<sup>56</sup> The analysis under MLI covered agreements will proceed in the same manner as under a non-covered treaty with the addition of the following question: how does the MLI apply to the treaty? An analysis of the PPT would be undertaken, unless an alternate anti-avoidance scheme under the MLI applied. This analysis would generally occur before consideration of the GAAR.

For purposes of the immediate discussion, assume Canco is a private (not a public) corporation.<sup>57</sup> The Canco shares remain taxable Canadian property.<sup>58</sup> Absent treaty relief, the gain on disposition by a non-resident will be taxable in Canada. Holdco, now a Luxembourg resident, would look to Article 13(4) of the Canada–Luxembourg treaty for an exemption to avoid Canadian tax.

For Canada to maintain its right to tax the gain, Holdco must have a substantial interest in Canco (10% or greater) and the value of the shares must be derived principally from real or immoveable property in Canada.<sup>59</sup> Assume that Holdco owns 9.99% of the Canco shares and the requirements for an exemption under the treaty are met. Also assume for purposes of the discussion that the gain is also exempt from tax in Luxembourg.<sup>60</sup>

55. The MLI will apply to withholding taxes on covered agreements where the MLI has come into effect in both jurisdictions, and 1 June 2020, for all other taxes. For countries where the MLI still needs to be ratified the MLI will not cover withholding taxes until the first day of the next calendar year of the MLI coming into force, and for all other taxes six months after the latest date it comes into force.

56. Canada has chosen to not make a reservation pursuant to art 7(15)(b) of the MLI, and per art 7(17)(a) has notified the OECD that the PPT shall supersede or replace existing similar provisions, see *Status of List of Reservations and Notifications upon Deposition of the Instrument of Ratification*, Department of Foreign Affairs, Trade and Development, 29 August 2019 at 22.

57. The change from a public to a private corporation is made because an exemption for capital gains on publicly traded shares was added under art 13(4) in 1999 to the Canada–Luxembourg Treaty. If Canco were publicly traded, the capital gain would be taxable in Luxembourg only and the CRA would have limited recourse to challenge.

58. The definition of TCP includes shares of a private corporation principally deriving their value from real or immoveable property in Canada within a five-year period. See *Act*, *supra* note 24 at s 248(1) “taxable Canadian property.”

59. Even if the substantial interest limit is exceeded, there are two limitations: First, if it is a publicly listed corporation, and second, if business was carried out on the real or immoveable property from which the shares derive their value (see *Alta Energy*, *supra* note 7.)

60. For Holdco to also receive a tax exemption under Luxembourg corporate law, Holdco would have to meet that country's qualifying shareholding requirements. For the purposes of this hypothetical, 9.99% is treated as meeting a Luxembourg exemption. Under current Luxembourg corporate law, eligible entities can be tax exempt if: 1. The shareholding constituted at least 10% of total ownership in the share capital or an acquisition price of at least €6 million and, 2. The company held the qualifying shareholding for at least 1 year, see Wim Pot, “Luxembourg, Corporate—Income Determination” (06 December 2018), *Worldwide Tax Summaries*, pwc.

To prevent this complete avoidance of tax, the CRA would look to its arsenal of tax avoidance rules. There are no specific domestic *ITA* rules to challenge the transaction, nor specific treaty rules. The GAAR was also soundly rebuffed in *MIL Investments* in similar circumstances. In that case, the Federal Court of Appeal held that even if the move by Holdco to Luxembourg was an avoidance transaction, there was no abuse of the tax treaty. There was no abuse because the treaty specifically provided an exemption for non-residents on the gains from the disposition of treaty exempt property.

The shares held by Holdco in Canco are also treaty exempt property. The court concluded in *MIL* that there is no reason to look behind compliance with the relevant provisions of the treaty to find an object or purpose whose abuse would justify departure from the plain words.<sup>61</sup> Would the result be different under the MLI? Will the new preamble and the PPT change the result in *MIL* or cause the courts to reach a different result based on the facts in the hypothetical posed? As discussed, the new wording introduced in the preamble alone is unlikely to change the outcome in *MIL* or operate to deny the benefit in the hypothetical. The preamble itself does not create obligations that are not expressly stated, nor does it overpower clear and unambiguous specific provisions in the treaty.<sup>62</sup> It cannot “function in a manner that would override specific treaty provisions.”<sup>63</sup>

The preamble does send a strong message that a purpose of the treaty is to prevent tax evasion and avoidance including through treaty shopping arrangements, but that is not sufficient on its own to override the clear language in specific provisions of the treaty under current Canadian law. This leaves the application of the new PPT to combat the treaty benefit.<sup>64</sup> Procedurally the PPT can be broken down as follows:

1. Evaluate all the relevant facts and circumstances to determine the transaction or arrangement that is at issue and the benefit given under the treaty, in addition to determining the relationship between the transaction or arrangement and the benefit;
2. Determine the principle purpose of the transaction or arrangement;
3. Deny a benefit if one of the principal purposes of a transaction or arrangement was to obtain the benefit; and

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61. *MIL Investments*, *supra* note 4 at para 6.

62. *Relevance of the Preamble*, *supra* note 15 at 6.

63. *Ibid* at 8.

64. Authorities do not necessarily have to rely on domestic anti-avoidance rules. This could allow for situations where the PPT applies before specific ITA anti-avoidance rules. See *International Tax Planning*, *supra* note 26 at 960. Such an approach would, however, be contrary to the traditional rules on the construction and application of laws in Canada.



4. Grant the benefit if it was in accordance with the object and purpose of the relevant treaty provisions.<sup>65</sup>

Although the language used in the PPT is similar to the GAAR, there are, or there may be, some substantial differences between the two anti-avoidance provisions.

The first potential difference is establishing what is to be included in determining “the transaction or arrangement at issue.” It has been suggested that there would be a narrower interpretation under the PPT than under the GAAR, which includes a deeming rule to include contemplated related transactions.<sup>66</sup> The other view is that the court’s interpretation of what is included in a series of transactions for purposes of the GAAR would produce the same results under the PPT.<sup>67</sup> This view is supported by the OECD Commentaries which provide that the expression “arrangement or transaction” within the PPT is to be construed broadly and includes a “more elaborate series of transactions.”<sup>68</sup> For the purpose of the current discussion it is assumed that all of the transactions in the hypothetical facts will be included in determining the transaction or arrangement at issue under the PPT.

The second difference is that the PPT looks to whether one of the principal purposes was to obtain a benefit. This is a subjective test. In *MIL*, the Court questioned the NRT, who plainly stated that the reason for the move to Luxembourg was for business reasons relating to operating a mining company in addition to tax reasons. Unlike the test under the GAAR, an admission that one of the principal purposes of the decision to move Holdco was to obtain a tax benefit is enough under the PPT to deny the benefit. However, under the PPT there is an additional step. The PPT will not apply to deny the benefit, if granting the benefit was in accordance with the object and purpose of the relevant treaty provision.

65. Svitlana Buriak, “The Application of the Principal Purpose Test under Tax Treaties,” *Tax Treaty Entitlement* (Vienna: IBFD, 2019) 1 at 29 [*Application of the PPT*].

66. Nathan Boidman & Michael N Kande, “Canada Enacts Multilateral Instrument: What Happens Next?” (2019) *taxnotes international*, 95:4 at 319.

67. The Supreme Court’s position in *Cophorne* restricts the term in such a way that a natural meaning of “series” for purposes of the GAAR would be functionally the same as “all relevant facts and circumstances” for purpose of the PPT and would include related events (with some nexus to the series) meant to achieve a planned or pre-ordained result. At paragraph 43 of *Cophorne*, the Court makes clear that a series is a pre-ordained set of transactions to produce a final result including contemplated related transactions in s 248(10), and that more than a “mere possibility” of a connection with related transaction must exist, specifically that the transaction be undertaken “in relation to” or “because of” the series. This does not need to be a “strong nexus” but does require a nexus, see *Cophorne*, *supra* note 9 at paras 43-47.

68. See OECD, *Commentaries on the Articles of the Model Tax Convention*, (OECD Publishing, 2010) Commentary of Article 29(9) at para 177; *Application of the PPT*, *supra* note 65 at 31.

This is a third difference from the GAAR. Under the GAAR, the CRA must establish *inter alia* that “granting the benefit is not consistent with the object, spirit or purpose of the provision.” Under the PPT the taxpayer must objectively show “that granting the benefit is in accordance with the object and purpose of the specific provision.”<sup>69</sup> Although this puts the onus on the taxpayer, it also gives the taxpayer the opportunity to make a full case. Is the granting of the treaty benefit in keeping with the object and purpose of the relevant treaty provision—in this case an exemption from Canadian tax on a capital gain under Article 13? As stated in both *MIL* and *Alta Energy*, Article 13 of the tax treaty was written with full knowledge by both parties of their respective domestic tax systems and to encourage investment in each jurisdiction. From the Canadian perspective, Article 13(4) provides for specific exemptions that were contemplated by both Governments (in position papers).<sup>70</sup> As expressed on two occasions by the courts,<sup>71</sup> the Government of Canada has the power to renegotiate more specific provisions in the treaty and the government chose not to do so. If a specific treaty provision is plainly worded to allow, for example, a Luxembourg investment vehicle to buy and sell Canadian stocks, injecting cash into the Canadian economy, it follows that granting the tax benefit to a taxpayer that does so would be in line with object and spirit of the provision.

Overall, the PPT appears to offer a broad net to catch transactions that fall through the cracks in existing Canadian anti-avoidance rules. Nonetheless, the final test to allow or deny treaty benefits within the PPT, based on whether the benefit is in accordance with the object and purpose of the relevant treaty provisions, logically mimics the analysis in the GAAR. One wonders why the outcome in treaty shopping cases would be any different when applying the PPT unless a very non-Canadian approach is taken by the Courts in applying the provision, or different rules are applied to determine the object, spirit and intent of a treaty provision.

##### 5. *Does the GAAR apply?*

Will the anti-avoidance provisions in the MLI lead to a different conclusion under the GAAR? The GAAR analysis will now presumably incorporate all aspects of a transaction and will include all aspects of the tax treaty,

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69. This is especially important as Canada has reserved its right to not include art 7(4) of the MLI in its covered tax agreements. This would have permitted the competent authorities to provide some or all benefits denied under the PPT.

70. Joint Book, Vol IX, Tab 117, at p 3016 in *Alta Energy*, *supra* note 7 at paras 42-45.

71. *MIL Investments*, *supra* note 4 and *Alta Energy*, *supra* note 7.

including the new preamble and the PPT.<sup>72</sup> Is the new preamble enough to alter the outcome under the GAAR?<sup>73</sup> Recall that treaty shopping was not referenced in *MIL* or *Alta Energy*. It is now specifically referenced in Canada's 84 covered treaties. Based on current Canadian law the outcome is unlikely to change based on the preamble alone and the taxpayer would remain successful.<sup>74</sup>

Assuming a benefit and an avoidance transaction are found for purposes of the GAAR, does the application of the PPT change anything? Under both anti-avoidance rules the critical question is whether the benefit is consistent with the object, spirit and intent of the treaty provision. Canadian courts have made clear that this determination should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do.<sup>75</sup>

Tax treaties are entered into by Canada to encourage investment. The court explicitly made this point in 2018 in *Alta Energy*.<sup>76</sup> Countries are presumed to know and understand each others' tax systems when they make treaties, and the Canadian government was free to negotiate a provision to stop this activity if it wished.<sup>77</sup> Unless there was evidence led by the CRA that the Government did not intend this type of planning, it should be considered to be within the object and purpose of the treaty and a side-effect of encouraging investment in Canada's natural resources (even if it is not agreeable to taxation authorities). If the government of Canada hopes to curtail benefits such as the receipt of tax-free capital

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72. Under a GAAR analysis the court would first determine the object, spirit, and purpose of the provision or provisions at bar by applying the "unified textual, contextual, and purposive" analysis. Second, the Court must then consider if the transaction "falls within or frustrates the identified purpose." This is an examination of the factual context of the case to determine whether the transaction or series as a whole, achieves an outcome that the statutory provision was intended to prevent; defeats the underlying rationale of the provision; or circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose. See *Deans Knight Income Corp v Canada*, 2019 TCC 76, TCJ No 58, at para 139.

73. This adapts the preamble to state "intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)." See MLI, *supra* note 13 at art 6(1).

74. As the court stated in *Alta Energy*, *supra* note 7 a tax treaty is a multi-purpose legal instrument. The preamble of the treaty states that the two governments desired "to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital." While indicative of the general purpose of the treaty, this statement remains vague regarding the application of specific articles of the treaty. Under the GAAR analysis, the Court must identify the rationale underlying Articles 1, 4 and 13, not a vague policy supporting a general approach to the interpretation of the treaty as a whole.

75. *Cophorne*, *supra* note 9 at paragraphs 69 and 70.

76. *Alta Energy*, *supra* note 7.

77. *Alta Energy*, *supra* note 7 at para 85.

gains by foreign investors on the disposition of Canadian source assets, the Court's position appears to be that the government must negotiate changes to the tax treaty that demonstrate a clear intention to do just that. In short, while there may be a general policy against treaty shopping, it cannot be automatically inferred that it should operate to prevent a taxpayer from using a specific and clearly worded treaty provision.<sup>78</sup>

#### 6. *Foreign domestic GAAR considerations*

Many of Canada's covered agreements are with countries that have their own general anti-avoidance rule. If the tax structure or arrangement involves an ongoing transaction between the covered treaty country and a third country, these GAAR provisions may apply in addition to the PPT. For example, the European Union GAAR, now in force in Luxembourg,<sup>79</sup> includes a PPT and commercial purpose test.<sup>80</sup> As recently noted by commentators, there are also a number of substance requirements that will have to be met under both Luxembourg and EU law.<sup>81</sup>

From the EU perspective, there could be much less reliance on the PPT than in Canada.<sup>82</sup> The EU GAAR may in fact be broader than the MLI PPT as there is not a reasonableness standard included in the wording of the provision.<sup>83</sup> Thus, Luxembourg or another EU state could resort to the

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78. As noted by the Supreme Court of Canada in *Canada Trustco Mortgage Co v Canada*, 2005 SCC 54, 2 SCR 601 at para 1, citing *Mathew v Canada*, 2005 SCC 55, a general policy is “but one consideration to be taken into account in determining Parliament’s intention with respect to a particular provision or provisions of the Act.”

79. As of 1 January 2019, the Anti-Avoidance Directive (ATAD) GAAR has been transposed on member state GAARs. See Antonio Weffer & Amar Hamouche, “Luxembourg Adopts the ATAD as well as Two other Important Provisions” (24 December 2018), online: *Baker McKenzie Publications* <<https://www.bakermckenzie.com/en/insight/publications/2018/12/luxembourg-adopts-the-atad>> [<https://perma.cc/9RS6-B7CL>] at 5. “The tax burden cannot be circumvented or reduced through the misuse of forms and institutions of private law,” and “entitles tax authorities to levy tax according to the effective economic operations, facts and circumstances.”

80. Richard Collier et al, “Dissecting the EU’s Recent Anti-Tax Avoidance Measures: Merits and Problems” (August 2018) vol 2, EconPol Policy Report, [EU’s Recent Anti-Tax Avoidance Measures] at 12. ATAD imposes two requirements: 1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part, and 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

81. This can include active professional boards in Luxembourg with the capacity to act for the company, qualified personnel, and key decision making occurring in Luxembourg, see Oliver Hoor, “The Concept of Substance in a Post-BEPS World” (2019) taxnotes international at 593-597.

82. The EU GAAR was constructed as a direct response to BEPS Action 6 which called for the implementation of a PPT in the OECD model treaty and grew into the current MLI PPT, see OECD Model, *supra* note 19.

83. *EU’s Recent Anti-Tax Avoidance Measures*, *supra* note 80 at 12.

GAAR before the application of the PPT under the treaty. If the benefit is granted under the GAAR it is unlikely that the PPT under the treaty would deny a benefit.

The situation is not the same with Canada's other large trading partners. In the case of the UK, for example, the GAAR is similar to the Canadian GAAR, and may thus be viewed as the broader rule. This contrasts with China, where the GAAR follows specific domestic ordering rules that could force its application before the PPT. It is likely that the implementation of the MLI will force a case by case analysis of the interaction of domestic GAARs, and their order of application for planners.

## 2. *Hypothetical 2*

The second hypothetical examines tax avoidance issues in two Canadian tax treaty cases, *Prevost Car* (2009) and *Velcro* (2012). At issue in both cases is whether the reduced tax treaty withholding rate applies to passive income (dividends or royalties) paid by a Canadian corporation (Canco) to a non-resident corporation (Holdco) and then by Holdco to a third corporation. In both cases the CRA argued that Holdco was not the beneficial owner of the payments as required by the tax treaty. In the CRA's view, the term 'beneficial owner' in this context means the person who can ultimately benefit from the payment. In both cases the Court rejected the CRA's interpretation of the meaning of beneficial ownership under the tax treaties in question. At the time of the decisions there were no anti-treaty shopping provisions in the relevant tax treaties. Two questions are posed.

1. Would the same result occur today under a non-covered tax treaty?<sup>84</sup>
2. Would the same result occur under the new MLI regime or will the CRA (or foreign competent authorities) use the preamble, the PPT (or any other provision) to deny the lower tax treaty withholding rate on such payments in similar circumstances?

### a. *Background*

In *Prevost Car*, UKco and Swedenco formed a joint holding company in the Netherlands, Dutchco, that held all shares of Canco. Under the arrangement Canco paid its dividends to Dutchco and withheld the 5% treaty rate under Article 10(2) of the Canada-Netherlands Tax Treaty, as opposed to the domestic withholding rate of 25%.<sup>85</sup> Dutchco then paid out dividends to both UKco and Swedenco respectively.<sup>86</sup> The 5% rate

84. See Appendix A Table.

85. *Act, supra* note 24 at s 212(2)(a).

86. There was no specific legal contract between Dutchco and its shareholders obligating it to

would not be available if Canco had paid the dividends directly to UKco or Swedenco.

The CRA reassessed the withholding tax rate on dividend payments made to Dutchco claiming it was not the beneficial owner of the dividends and therefore Dutchco was not entitled to treaty benefits.<sup>87</sup> Both the Tax Court and the Federal Court of Appeal<sup>88</sup> disagreed.<sup>89</sup> The Tax Court outlined the Canadian position on the meaning of beneficial ownership under a tax treaty as follows: “the ‘beneficial owner’ of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received.”<sup>90</sup> The Federal Court of Appeal upheld the Tax Court’s position stating that the Crown was seeking to “adopt a pejorative view of holding companies which neither Canadian domestic law, the international community nor the Canadian government through the process of objection, have adopted.”<sup>91</sup> This position was echoed by then ACJ Rossiter in 2012 in his decision in *Velcro*.<sup>92</sup> The *Velcro* decision also added further clarity to the beneficial ownership test.<sup>93</sup> In all three decisions the courts also refused to pierce the corporate veil, opining that they would only consider that option if the corporation had no discretion whatsoever over the funds.

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distribute dividends, instead the parents signed a shareholder’s agreement stipulating they would receive 80% of net profits from Canco and Dutchco.

87. *Prevost Car*, *supra* at note 6 at paras 1-26.

88. *Prévost Car Inc v Canada*, 2009 FCA 57, [2009] at 241 [*Prevost Car FCA*].

89. At the time of *Prevost Car*, two experts, Professors Dr. S van Weeghel and Rogier Raas provided evidence that under Dutch law Dutchco was the beneficial owner of the shares. Evidence was led by Prevost’s counsel in the case that highlighted a difference of opinion between Canadian and Dutch authorities that led to a break in communication between the parties as the Dutch authority recognized Dutchco as the beneficial owner; only if there was a legal obligation to forward the dividends would Dutch law ignore Dutchco as beneficial owner (*Prevost Car*, *supra* note 6).

90. *Ibid* at para 100: “The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short, the dividend is for the owner’s own benefit and this person is not accountable to anyone for how he or she deals with the dividend income.”

91. *Prevost Car FCA*, *supra* note 88 at para 15.

92. *Velcro Canada Inc v Her Majesty The Queen*, 2012 TCC 57, [2012] DTC 1100, [*Velcro*] at paras 1-14.

93. In *Velcro*, *supra* note 92, Canco paid royalties under a license agreement to VIBV, a Netherlands-resident corporation. VIBV relocated to the Netherlands Antilles and created a subsidiary holding company, Dutchco, in the Netherlands. VHBV then assigned their licenses to Dutchco. After this change, Canco paid its royalties and withheld 10% of its payments to Dutchco. Under an agreement between VIBV, and Dutchco, VIBV was paid an arms length percentage of the net sales of licensed products within 30 days of Dutchco receiving royalties. The CRA again denied the benefit of the lower tax treaty rate under the Canada–Netherlands Treaty. The Tax Court outlined the test that would be applied to determine if Dutchco had beneficial ownership over the royalty funds: possession, use, risk, and control. Essentially, in *Velcro* the Court asks if the Holdco exercises dominion and the qualities of ownership over the funds they are receiving or are they merely a fiduciary that is completely obligated and at the direction of another who exercises control over the funds? As in *Prevost*, the Court found that Dutchco had discretion and ownership over the funds even with contracts between the parties.

b. *Non-covered agreements*

Since *Prevost* and *Velcro* were decided, the OECD Commentaries provide an interpretation of “beneficial ownership” that looks to “the full right to use and enjoy the [income] unconstrained by a contractual or legal obligation to pass the payment received to another person.”<sup>94</sup> This invites two questions. Will the revised commentary be applied in Canada to determine the meaning of beneficial ownership for tax treaty purposes? If so, does this proposed formulation of the “beneficial ownership” test make it more difficult to satisfy than the beneficial ownership test applied in *Prevost* and *Velcro Canada* and would it change the result? In summary, the answer to the first question is yes and to the second question no. These answers are discussed below.

The Federal Court of Appeal made clear in *Prevost* that modern commentaries written after the signing of the treaty may be used where they are eliciting or complementary to views previously expressed at the time of the treaty’s creation, but not if they are contradictory.<sup>95</sup> The revised commentary on Article 10 now specifically addresses the use of an agent, nominee, and conduit company as circumstances where the recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass the payment on to the ultimate beneficiary.<sup>96</sup>

If the OECD commentary is applied by Canadian courts would it change the result in *Prevost*<sup>97</sup> or *Velcro*? Likely not. Beneficial ownership will still be found with the DutchCo.<sup>98</sup> However, that is not the end of the matter. The OECD Commentary in Article 10 goes on to provide:

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94. 2012 amendments to the OECD Commentary. “In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the “beneficial owner” because that recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person.”

95. *Prevost Car FCA*, *supra* at note 88 at para at para 12.

96. This can also include a fact specific analysis of the circumstances to ascertain if the recipient had a constrained right to use and enjoy the dividends; See OECD Model, *supra* note 19 at 234, para 12.4.

97. See Appendix A.

98. As the federal Court of Appeal pointed out in *Prevost Car FCA*, *supra* note 88 at para 16, Dutchco:

1. did not possess an agency or fiduciary relationship with the parent companies;
2. did not possess a conduit relationship as it had discretion with what to do with the funds;
3. was not subject to action from the parent companies if it did not follow the dividend policy set out in the shareholder’s agreement;
4. was not party to the shareholder’s agreement;
5. did not have a legal obligation to pay the dividends;
6. was obligated to follow Dutch law paying dividends and paid for and owned the shares so

The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on “Improper use of the Convention” in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. *Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases* [emphasis added].

Has there been an abuse of the treaty provision for purposes of any Canadian anti-avoidance provision including the GAAR? Under Canadian law the answer remains no.<sup>99</sup> This would leave only the application of the MLI avoidance provisions, including the PPT to potentially deny a benefit under a covered agreement. This issue is discussed below.

*c. MLI-covered agreements: Canada–Netherlands (EU)*

The PPT requires the courts to evaluate the relevant facts and circumstances to determine the transaction or series and the relationship between the benefit and the transaction or series. If a benefit is found, it must be shown that granting the benefit is in accordance with the object and purpose of the treaty provision. It is critical, therefore, to determine what is within the object and purpose of the provision at issue.

It is clear from the commentary that it is not within the object and spirit of the provision to provide a treaty exemption for agents or nominees or for conduit corporations; in the former case because there is no taxation in the host country, in the latter because the conduit receives the benefit for someone else. If it is contrary to the object and purposes of the provision to provide treaty benefits to one who is not the beneficial owner of the dividends, the court’s interpretation of the concept of beneficial ownership concept will remain key in determining whether a treaty benefit is granted under the MLI.

Will Canadian courts follow past precedent in interpreting the concept of beneficial ownership in a treaty context or embrace a broader meaning

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when it received dividends, they were available to its creditors until an interim dividend was declared.

99. Treaty shopping was specifically not found to be abuse in *Alta Energy*, *supra* note 7 and *MIL Investments*, *supra* note 4.



under the PPT to prevent so-called treaty shopping arrangements? This would require that Canadian judges answer questions such as—What is treaty shopping? Does it exist on a spectrum of avoidance-abuse? Where is the bright-line between using treaties to gain benefits as is their express purpose in business planning and planning into abusive treaty shopping arrangements?

It is more likely that Canadian courts will continue to interpret the concept of beneficial ownership based on Canadian case law. Echoing the decision in *MIL*, the parties were aware of what they saw as a flaw in the provision based on each state's taxation system, and they took no action to correct it in the treaty.<sup>100</sup>

The application of the PPT to the facts in *Prevost* would proceed as follows: the transactions will include the creation of Dutchco by Swedenco and UKco, the payments of dividends to Dutchco by Canco using the 5% treaty withholding rate, and finally the payment of dividends from Dutchco to both parents (likely tax-free under the EU's Parent-Subsidiary Directive). The purpose(s) of the transaction were elaborated on by a senior Vice-President of Swedenco who stated the motivations were taxation, a neutral territory between the UK and Sweden, an English-speaking business market, and a location that was cost efficient. Under part three of the PPT, the benefit would be denied because accessing preferential treaty withholding rates was one of the admitted and main purposes. The taxpayer would then have to show under part four, that granting the benefit was in accordance with the object and purpose of the treaty provision in order to preserve the benefit.

The taxpayer would argue that the object and purpose of the treaty is to encourage investment by providing reduced withholding tax rates on dividends paid to their beneficial owners. Dutchco is the beneficial owner of the dividends under the treaty and the benefit should therefore be allowed. The CRA would no doubt counter that it is not the object and purpose of Article 10(2) to allow a corporation without any physical presence in the Netherlands to access a treaty withholding rate, erode the Canadian tax base, and provide the funds to non-resident parent corporations who have higher treaty withholding rates with Canada, and a tax-free distribution within the EU. The new preamble introduced under the MLI adds weight to the argument that one of the purposes of the treaty is to prevent treaty shopping.

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100. Granting a reduced withholding rate is the very purpose of the treaty and in the absence of a positive response by state actors to change the treaty the benefit should be granted.

Based on Canadian case law to date, it seems more likely that the PPT would not operate to deny the benefit in MLI covered agreement transaction. If Dutchco is in fact the beneficial owner of the dividends, a more specific anti-avoidance rule such as a modified or detailed limitation of benefit provision would be required.

d. *Netherlands considerations*

Canada's position is not the only one that should be considered by business and planners. In the *Prevost* hypothetical, the Netherlands could block the beneficial treaty rate on the second set of dividends paid from Dutchco to the other EU entities (Swedenco and UKco). Whether the Netherlands would be successful will depend on Dutch law, an area of expertise outside the scope of this paper. Nonetheless some general observations can be made.

First, the dividends will be exempt from withholding tax between EU countries if the conditions set out in the EU Parent-Subsidiary Directive are met. Second, the European Court of Justice recently passed judgement on a set of beneficial ownership cases and attempted to provide clarity on “beneficial ownership” in tax treaties between EU member states. These cases, as noted by commentators, have moved the EU towards a common understanding of beneficial ownership in tax treaties between member states covered by the Parent-Subsidiary Directive.<sup>101</sup>

Third, in treaties between non-EU and EU states containing Article 3(2), each state will still look to a domestic law definition. There is no domestic definition of beneficial ownership in Dutch Tax Law.<sup>102</sup> This would lead a court to look at the definition of “uiteindelijk gerechtigde,” the Dutch term in the translated treaty, which literally means “he who is ultimately entitled.”<sup>103</sup> In either case Dutchco would be considered the beneficial owner of the dividend without a distinct legal obligation to pay dividends to the parent companies.<sup>104</sup>

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101. Jonathan Schwarz, “Beneficial Ownership: CJEU Landmark Ruling” (27 February 2019), online: *Kluwer International Tax Blog* <[http://kluwertaxblog.com/2019/02/27/beneficial-ownership-cjeu-landmark-ruling/?doing\\_wp\\_cron=1587757382.0886158943176269531250](http://kluwertaxblog.com/2019/02/27/beneficial-ownership-cjeu-landmark-ruling/?doing_wp_cron=1587757382.0886158943176269531250)> [<https://perma.cc/JHX7-MZWL>].

102. “The Dutch dividend withholding tax exemption broadened” (19 January 2018), online: *Tax Consultants International* <<https://www.tax-consultants-international.com/read/the-dutch-dividend-withholding-tax-exemption-broadened-2018-?sublist=5990&submenu=16955>> [<https://perma.cc/TW39-AR2K>].

103. *Prevost Car*, *supra* note 6 at para 81.

104. Florian Navisotschnigg, “The Beneficial Ownership Test,” *Tax Treaty Entitlement* (Vienna: IBFD, 2019) 1 at 116.

e. *Treaty specific anti-avoidance rule*

As previously discussed, 43 of Canada's 93 tax treaties include an anti-conduit rule that operates to deny treaty benefits in defined circumstances. For example, in Canada's treaty with Hong Kong, the anti-conduit rule applies to all of the income articles.<sup>105</sup> In the case of Taiwan, the rules apply to the entire treaty.<sup>106</sup> The operation of the provision is straightforward and provides a clear test for denying treaty benefits. If Canco distributes dividends to HKco who in turn distributes dividends (under the same non-legal obligation) to its non-resident shareholders, HKco will be denied access to the benefits of the treaty on the distribution unless the tax rate it pays in Hong Kong is the same as if its shareholders were Hong Kong residents.

3. *Hypothetical 3*

The final hypothetical looks at tax efficient arrangements commonly used by Canadian businesses to finance their foreign subsidiaries, often referred to as double-dip financing. Double-dip financing allows for an interest deduction in Canada and an interest deduction in the foreign jurisdiction where the active business subsidiary is located on a single sum of loaned money.<sup>107</sup> More complicated double-dip arrangements include "Tower Structures" that allow for the deduction of interest costs by the Canadian corporation for Canadian tax purposes and the deduction of the corresponding interest costs by the foreign subsidiary for foreign tax purposes without the payment of withholding tax on the repatriation of the funds.

A tower structure was before the Tax Court in the case *Bank of Montreal v The Queen*.<sup>108</sup> In that case, BMO lent \$1.4 USD to its BMO Harris Group through three entities. First it invested the funds in a Nevada limited partnership, which then invested in a Nova Scotia unlimited liability company, which in turn invested in a Delaware limited liability company, who finally lent the money to BMO Harris.<sup>109</sup> BMO Harris gained an

105. *Agreement Between the Government of Canada and the Government of the Hong Kong Special Administrative Region of The People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, Canada and Hong Kong, 11 November 2012, art 26(3).

106. The benefits are denied if an entity is beneficially owned or controlled directly or indirectly by one or more persons who are not residents of the entity's state of residence, if because of non-resident ownership or control, the amount of tax imposed on the entity is less than it would be if the owners were resident that state.

107. Brian J Arnold, "Double-Dip Financing Arrangements," *Taxation of the foreign-Source Income of Canadian Residents*, (2009) 9 at 9:2.

108. *Bank of Montreal v The Queen*, 2018 TCC 187, TCJ No 138 [BMO].

109. BMO, *supra* note 108 at paras 4-16.

interest expense when it paid interest to the Delaware LLC. The Delaware LLC sent dividends backwards through the chain ultimately arriving back with BMO in Canada. BMO Canada also gained an interest expense from the original loan with the third party. The Minister agreed that the tower structure complied with the *ITA*.<sup>110</sup> The question posed is: does the PPT provide foreign competent authorities with new opportunities to challenge double-dip financing structures affecting their jurisdiction?

Assume for purposes of the discussion that a Canadian subsidiary, Luxco, is in Luxembourg and another, Fraco, an active business corporation, is in one of Europe's higher tax zones, France. Canco borrows \$5 million from a lender in Canada which it uses to purchase shares in Luxco. Luxco subsequently loans \$5 million to Fraco.

a. *Luxembourg–France tax treaty*

Under Article 10(1) of the Luxembourg–France Treaty, interest is only taxable in the state where the interest is received.<sup>111</sup> This would allow Luxco to receive the interest fully exempt from any French withholding taxes. Here, although interest flows are not subject to withholding tax, they are subject to an arms-length reasonability requirement under Luxembourg domestic law.<sup>112</sup> There is a second hurdle that would have to be jumped. Article 28 of this treaty adds a principle purpose test for entitlement to benefits, the wording of which is the same as the PPT contained in the MLI.<sup>113</sup> Luxco must demonstrate to French revenue authorities that one of its principal purposes was not to obtain the 0% withholding tax rate between jurisdictions. This will be a significant hurdle, and the first of two instances where the transaction will be scrutinized under a PPT. It will not be hard for French authorities to show one of the principal purposes of the series was to obtain a 0% interest withholding tax as that is part of the double-dip financing scheme. France could also use their GAAR to attempt to block the benefit should the treaty fail to do so.<sup>114</sup>

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110. The structure was challenged under the GAAR for other reasons, although the minister was unsuccessful, see *BMO*, *supra* note 108 at para 15.

111. “New Double Tax Treaty between Luxembourg and France” (22 March 2018), online: *PwC Flash News* <<https://www.pwc.lu/en/tax-consulting/docs/pwc-tax-220318.pdf>> [<https://perma.cc/3HUQ-3VRQ>] at 4 [New Treaty].

112. *Ibid.*

113. New Treaty, *supra* note 111 at 7.

114. As previously stated, the new European GAAR contained in ATAD is almost identical to the rule contained in art 28 of the treaty: “no account will be taken of an arrangement or a series of arrangements which, having been put into place for the main purpose, or one of the main purposes, of obtaining a tax benefit that is contrary to the object or purpose of the applicable legal provisions, are not genuine considering all relevant facts and circumstances.”

The interest received by Luxco would then be paid as a dividend back to Canco. There is unlikely to be a treaty challenge in Canada given the nature of the financing scheme which is allowed under Canadian law.

b. *Canada–Luxembourg tax treaty*

Under Article 10(2) of the Canada–Luxembourg Treaty, dividends are subject to a reduced withholding rate of 5%. Under a double-dip financing structure, the dividend paid from a subsidiary back to its parent in Canada, if paid out of an exempt surplus pool,<sup>115</sup> will not be taxed in Canada.<sup>116</sup> This 5% treaty withholding rate is the only tax the dividends would face on repatriation to Canada.<sup>117</sup>

Under the MLI, the PPT will serve as a tool that Luxembourg authorities could use to prevent the lowered withholding rate. Practically, this would seem unlikely as Luxembourg has benefited from corporate and municipal taxes on Luxco’s income.<sup>118</sup>

The bottom line is that businesses operating under MLI-covered agreements may now be subject to multiple PPT tests, particularly in cross border financing arrangements. Where jurisdictions are not favourable to this type of financing arrangement treaty benefits may be denied.

*Conclusion: Limited change from the status quo*

When Canada agreed to implement the PPT as a minimum standard in its covered agreements there was a large degree of uncertainty as to how much change would be on the horizon for Canadian international business. After assessing the hypotheticals in this paper, it appears that the minimum standard introduced by the MLI is unlikely to change the analytical approach to tax treaty transactions in Canada from the previous GAAR approach. For the most part the status quo will remain.

Though Canada’s GAAR will likely still be a consideration when cases are brought before the courts, it will more likely be the PPT that will decide the matter under covered agreements. If the transaction or arrangement

115. *Act, supra* note 24 at s 113(1)(a), allows for the full deduction of dividends received from a foreign affiliate’s “exempt surplus” arising from active business income.

116. *Act, supra* note 24 at s 95(2)(a).

117. As a reminder, the interest faced no withholding tax leaving France and entering Luxembourg. Nor would Canada tax the dividend when it entered Canada. The only taxes that arise are Luxembourg domestic corporate and municipal taxes on Luxco, and the 5% exit withholding rate.

118. If subject to a second PPT, it would have to be shown that one of the primary purposes for making the transaction was not the reduced withholding rate. As this is the second leg of the transaction there would be greater scrutiny as there are more parts of the series authorities could analyze including the interest payment from FraCo. Though unlikely, Luxembourg could stop the lowered withholding rate using the PPT should they be able to show that the lowered rate was one of the primary purposes (which was a major consideration in the double-dip scheme as a whole) and that granting the benefit was not the object or spirit of the provision (allowing for a treaty shopping double-dip arrangement).

satisfies the GAAR's object, spirit, and purpose test then in most cases the PPT will be satisfied as well. As demonstrated in the discussion of *Prevost* and *Velcro*, courts might have the option of adopting a different viewpoint in the PPT's object and purpose analysis but even then, it is likely they will come to the same conclusion they would under GAAR. Additionally, by merely adapting the preamble of tax treaties to reference treaty shopping, the preamble's influence over substantive provisions of the treaty is limited. As discussed throughout this paper, the preamble, in international and domestic law, is viewed only as a contextual framing mechanism and is not in and of itself substantive. It will be left to the courts to determine how they will tackle treaty shopping.

In many cases the application of the PPT as a minimum standard will be temporary, and Canada will adopt a DLOB provision in its tax treaties similar to that found in the Canada-United States Treaty. This will lead to further certainty. Until DLOB provisions are negotiated, the following should be kept in mind:

1. The PPT will live next to existing rules and will likely be used as a catch-all where domestic anti-avoidance, treaty anti-avoidance, and GAAR have failed to deny a benefit;
2. On a plain reading of the PPT, most tax benefits under a treaty will be denied in part three of the PPT. However, part four of the PPT, —is the benefit in accordance with the object and purpose of the treaty provision, is the most crucial element of the PPT;
3. If the GAAR does not operate to deny a benefit because the benefit is in line with the object, spirit, and purpose of the provision, then the same result is likely under the PPT.
4. The PPT applies to a series of transactions according to the OECD commentary. The series used in the GAAR analysis is likely the same as the series that will be scrutinized under the PPT;
5. The tax regime in the other country involved in the transaction should be a major consideration in both the planning for and arguments against the PPT. Object and purpose under the PPT will logically be similar in form to GAAR and require an understanding of the practical tax and policy positions of both governments;
6. In situations where unique terms such as beneficial ownership are used, the PPT may produce a different result than GAAR if the courts give more preference to international law and OECD commentaries than domestic jurisprudence has allowed;

7. When dealing with the European Union, the PPT and ATAD GAAR are complimentary to one another. Should one be satisfied the other surely is as well;
8. For financing structures such as double-dips, the result will likely be the same under the PPT in Canada as under our existing system, but the PPT will provide multiple opportunities to challenge double-dip structures in jurisdictions less favourable to the practice; and
9. As in most law, judicial personalities will be key to the application of the PPT and how Canada initially responds to it. If current trends continue it is unlikely that Canadian Courts will respond with a heavy hand in applying the PPT unless the abuse is abundantly clear.

To quote T.S. Elliot, the MLI is unlikely to come onto the Canadian legal stage with a bang, instead it shall arrive with a whimper.

The MLI entered into force in Canada on 1 December 2019, and into effect on 1 January 2020 for many covered agreements.<sup>119</sup> Notwithstanding that the PPT will be the ultimate decision maker in covered agreements, it is unlikely to alter results previously seen under the GAAR.

The primary concern raised by the Department of Finance in its 2013 Treaty Shopping Consultation paper remains: Is there strong enough language being used in legislation to prevent treaty shopping?<sup>120</sup> As this paper has shown, the answer is no. It is unlikely that the MLI, as currently implemented by Canada, will satisfy Finance's legislative goal. The introduction of DLOB provisions will be required.

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119. Withholding taxes on covered agreements where the MLI has come into effect in both jurisdictions, and 1 June 2020, for all other taxes. For countries where the MLI still needs to be ratified the MLI will not cover withholding taxes until the first day of the next calendar year of the MLI coming into force, and for all other taxes six months after the latest date it comes into force.

120. "Collectively, these three cases (*MIL*, *Prevost*, *Velcro*) indicate in relatively strong terms that the courts in Canada are not currently inclined to find against taxpayers in treaty shopping cases. In other words, the courts in Canada require clearer legislative direction to the effect that treaty shopping is an improper use of Canada's tax treaties," see Canada, Department of Finance, "Consultation Paper on Treaty Shopping—The Problem and Possible Solutions," (August 2013) online (pdf): *Department of Finance* <<https://www.thor.ca/blog/wp-content/uploads/2013/08/Consultation-Paper-on-Treaty-Shopping.pdf>> [<https://perma.cc/R4N5-QEUG>].

**Appendix A**

*Table 1: Canadian Covered Tax Agreements*

<b>Treaties Covered by the Convention (84)</b>			
Algeria	Estonia	Latvia	Russia
Argentina	Finland	Lithuania	Senegal
Armenia	France	Luxembourg	Serbia
Australia	Gabon	Malaysia	Singapore
Austria	Greece	Malta	Slovak Republic
Azerbaijan	Hong Kong	Mexico	Slovenia
Bangladesh	Hungary	Moldova	South Africa
Barbados	Iceland	Mongolia	Spain
Belgium	India	Morocco	Sri Lanka
Brazil	Indonesia	Netherlands	Sweden
Bulgaria	Ireland	New Zealand	Tanzania
Cameroon	Israel	Nigeria	Thailand
Chile	Italy	Norway	Trinidad and Tobago
China	Ivory Coast	Oman	Tunisia
Colombia	Jamaica	Pakistan	Turkey
Croatia	Japan	Papua New Guinea	Ukraine
Cyprus	Jordan	Peru	United Arab Emirates
Czech Republic	Kazakhstan	Philippines	United Kingdom
Denmark	Kenya	Poland	Vietnam
Dominican Republic	Kuwait	Portugal	Zambia
Egypt	South Korea	Romania	Zimbabwe

*Status of List of Reservations and Notifications at the Time of Signature, Department of Foreign Affairs, Trade and Development, 30 May 2017, <<http://www.oecd.org/tax/treaties/beps-mli-position-canada.pdf>>*



*Table 2: Canadian Treaties Not Covered by the MLI Convention*

<b>Treaties Not Covered by the Convention (9)</b>	<b>MLI Signatory</b>
Ecuador	No
Germany*	Yes
Guyana	No
Kyrgyzstan	No
Switzerland*	Yes
Taiwan	No
United States	No
Uzbekistan	No
Venezuela	No
*Negotiations ongoing	

*Signatories and Parties to the Multilateral Convention to Implement Tax treaty Related Measures to Prevent Base Erosion and Profit Shifting*, Status as of 29 August 2019, OECD, <<https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>>