Policy Forum: Canada’s Anti-Treaty-Shopping Proposals and International Treaty Obligations

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INTRODUCTION

Treaty shopping1 is a deepening global controversy with competing interests across the private and public spectrum. The Organisation for Economic Co-operation and Development (OECD) has identified “treaty shopping” as one of the most important

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1 The expression “treaty shopping” has been defined by the OECD on various occasions. It is commonly understood to mean attempts by residents of third states to access the benefit of a treaty between two contracting states. In the consultation paper (infra note 12), Finance stated that such a practice is generally considered an “improper” use of treaties, and cited the OECD commentary (infra note 8).
sources of base erosion and profit shifting (BEPS) concerns.2 The Canadian Department of Finance announced proposals regarding domestic anti-treaty-shopping legislation (“the proposals”) in the 2014 federal budget.3 Finance released draft legislation on August 29, 2014 implementing measures from the 2014 budget but did not include the proposals.4 Finance stated that after engaging in consultations on the proposals, it will await further work by the OECD and the G20 in relation to the BEPS initiative. On September 16, 2014, the OECD released its BEPS recommendations, which are designed to create a single set of international tax rules to end base erosion and the artificial shifting of profits.5 This release included the OECD’s Action 6 report.6 The effect of the Action 6 report on the formulation of proposed amendments (“the future proposals”) is unknown at this time.

The premise of this article, which was originally written before the release of the Action 6 report, is that Finance will propose draft domestic anti-treaty-shopping legislation amending the Income Tax Conventions Interpretation Act7 (ITCIA) that will prevail over Canadian tax treaties to the extent that there is inconsistency.

The proposals represent a profound change to Canadian international tax policy. The potential adverse effect is inestimable, especially for investors who have relied in good faith on well-established Canadian treaty policy not to mention relevant Canadian case law. In this article, I argue that, prior to the release of the Action 6 report, there were compelling reasons why the proposals would breach Canadian legal obligations under many tax treaties and especially those treaties in force prior to the 2002 update to the OECD model convention adopted by the Council of the OECD on January 28, 2003 (“the 2003 commentary”);8 moreover, the claims made in support of the proposals by Finance are not supported by the 2003 commentary. The proposals also conflict with the OECD public discussion draft on BEPS Action 6.9 I anticipate that Finance will be drafting the future proposals in a manner that will allow it to claim that it is following the Action 6 report.

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4 Canada, Department of Finance, Legislative Proposals Relating to Income Tax and Sales Tax (Ottawa: Department of Finance, August 29, 2014).
7 Income Tax Conventions Interpretation Act, RSC 1985, c. I-4, as amended.
Subject to the formulation of the future proposals, I submit that Finance should address treaty shopping by negotiating treaty amendments to reflect its new treaty policy regardless of any delays and concessions that may be required. I do not recommend improving the proposals, and therefore I do not focus on their architecture or details. Excellent reviews of these matters are available elsewhere.¹⁰

**FIRST PRINCIPLES FIRST**

The genesis of the proposals is the 2013 federal budget, which announced the treaty-shopping consultation process.¹¹ This announcement was followed by the release of the consultation paper,¹² which formed the basis for a period of consultation leading to the release of the proposals in the 2014 federal budget. The consultation paper summarizes possible approaches to prevent treaty shopping. As stated by Finance, the threshold question is whether treaty shopping should be addressed by Canada’s domestic tax laws or whether Canada should negotiate treaty-based rules. Finance stated that “a treaty based approach, on its own . . . would not serve as a timely response to the treaty shopping problem faced by Canada today.”¹³

In contrast, if Canada were to adopt a domestic law approach, amendments could be implemented in a timely manner. Domestic law provisions to prevent tax treaty abuse are endorsed by both the OECD and the United Nations (the “UN”); both organizations consider that tax treaties may be subject to domestic anti-avoidance rules in cases involving treaty shopping. For clarity, if a domestic law approach were adopted, it would provide that the domestic law provisions prevail over tax treaties; however, it should be recognized that Canada’s intention would be to clarify and codify its position concerning treaty shopping in a manner consistent with the OECD and UN Model Commentaries as well as the laws and practices of several other countries.¹⁴

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¹¹ Canada, Department of Finance, 2013 Budget, Budget Plan, March 21, 2013, at 373.

¹² Canada, Department of Finance, Treaty Shopping—The Problem and Possible Solutions (Ottawa: Department of Finance, August 2013).

¹³ Ibid., at section 6.2.

¹⁴ Ibid. (emphasis added, notes omitted).
In the 2014 budget, Finance clearly stated its preference for a domestic-law approach. It reiterated the justification for such an approach described in the consultation paper:

Several stakeholders expressed a preference for a solution to treaty shopping that would require the re-negotiation of Canada’s tax treaties. This is based in large part, on the view that a domestic law response to treaty shopping would alter the balance of compromises reached in the negotiation of tax treaties. However, the absence of an anti-treaty shopping rule in a tax treaty does not mean that there is an implicit obligation to provide benefits in respect of abusive arrangements. As discussed in the consultation paper, domestic law provisions to prevent tax treaty abuse are not considered by the OECD or the United Nations to be in conflict with tax treaty obligations and a number of other countries have enacted legislation to that effect.

In addition, some stakeholders have asserted that only a few of Canada’s tax treaties would need to be re-negotiated in order to significantly curtail treaty shopping. As stated in the consultation paper, even if it were possible to re-negotiate—within a reasonable period of time—Canada’s treaties with certain countries where conduit entities are common, other conduit countries may emerge. Accordingly, a treaty-based approach would not be as effective as a domestic law rule.15

Finance thus provides two justifications for a domestic-law approach. The first is that there will not be any conflict between the proposals and tax treaties, a justification apparently based on the proposition articulated in the 2003 commentary that domestic rules determine the facts that give rise to tax liability and therefore do not conflict with tax treaties.16 Second, Finance refers to the time and uncertainty involved in treaty renegotiation and says that other conduit countries may emerge to frustrate such efforts. Second, Finance implies that other countries have enacted domestic anti-abuse rules. However, Finance does not comment on the substance of such legislation in specified countries having regard to their respective legal and tax systems and tax treaties, or on how any of the foregoing may differ from the proposals and from the Canadian context. Nor does it comment on whether these other countries are overriding their tax treaties. The selective and casual mention of other jurisdictions cannot serve as a legal or policy justification for the proposals. In addition, the proposals are inconsistent with the 2003 commentary that refers to “main purpose” and “object and spirit.”17

15 2014 budget, supra note 3, at 350-51.
16 See the 2003 commentary, supra note 8, at paragraphs 8-22.1 of the commentary on article 1.
17 It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above. A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.
The analysis of whether the proposals will breach any Canadian tax treaty, regardless of when it became effective, should not start with OECD commentary on the model convention: it is necessary to first define Canada’s legal obligations under its tax treaties. An international principle of primary importance is pacta sunt servanda (the parties must honour the agreement). This maxim expresses one of the fundamental and universally recognized principles of the law of treaties; indeed, the principle “serves as a cornerstone of social interaction, peace and justice.”

The principle has been codified in the preamble and article 26 of the Vienna Convention on the Law of Treaties 1969, to which Canada has subscribed. It reads as follows: “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.” Without such a principle, no treaty would be binding. Canadian courts have upheld this obligation.

Article 31(1) provides that a treaty is to be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. The intention of the parties is of central importance in international law. Determining intention is not a search for a subjective determination; rather, it is a search for an objective determination derived from the text of the treaty and the interpretive rules of articles 31 and 32 of the Vienna Convention. Articles 31(2) and (3) discuss context. Article 32 addresses supplementary means of interpretation. No mention is made of OECD commentaries, and the provision does not expressly authorize the use of supplementary means of interpretation arising after the particular treaty was concluded.

The relationship between the OECD commentaries and the Vienna Convention is nuanced and complex and has been the subject of many learned texts and articles. Observers have noted that there is no consensus concerning the application of articles 31 and 32 and the commentaries.

The determination whether the proposals will contravene Canada’s treaty obligations must relate to a specific tax treaty and must be based on accepted principles of treaty interpretation and the relevant case law. This determination is not decided with finality by the ever-changing OECD commentary, as helpful as the commentary may be in the negotiation and interpretation of particular bilateral treaties.

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20 For example, David A. Ward et al., The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model (Kingston, ON and Amsterdam: International Fiscal Association (Canadian branch) and International Bureau of Fiscal Documentation, 2005).
Canadian tax treaties, with certain exceptions,21 do not have any language suggesting that the signatories were concerned with treaty shopping, let alone that they desired to curtail it. The entitlement to treaty benefits under Canadian tax treaties is not ambiguous and has been judicially considered. Finance’s assertion that the proposals are consistent with obligations under all of Canada’s tax treaties without exception is untenable for the reasons discussed in the next part of this article.

A CRITIQUE OF THE CLAIM THAT THE PROPOSALS DO NOT CONFLICT WITH CANADA’S TAX TREATIES

Status of OECD Commentaries

The changes to the commentary on article 1 of the OECD model convention strongly suggest that one can reject previous comments of the OECD to the effect that under the pacta sunt servanda principle anti-abuse measures must be included in treaties and that in their absence treaty benefits must be granted.22 The changes have shifted the onus: states that have entered observations must put provisions into their treaties to restrict the application of domestic anti-avoidance rules of the other states.23 These observations do not derogate in any way from the argument that Finance misconstrues the status of the OECD commentaries on prior treaties, seemingly disregards Canadian case law on the status of the OECD commentary in interpreting tax treaties, and does not mention specific observations by Luxembourg and the Netherlands concerning the 2003 commentary. Also noticeably absent is any mention of the approximately 81 tax treaties entered into before the 2003 commentary.

Paragraph 22.1 of the 2003 commentary, which posits that domestic rules determine the facts that give rise to tax liability and therefore do not conflict with tax treaties, does not provide a legal justification for a comprehensive treaty override, and it cannot plausibly be considered an invitation or permission from the OECD to enact domestic anti-treaty-shopping legislation. To conclude that there was no obligation to extend treaty benefits would require much stronger wording in view of prior OECD statements on negotiating treaty amendments, not to mention a legal justification that would cover every tax treaty. Finance seems to have elevated the 2003 commentary to legal authority in supporting the proposals—an interpretation that a court would not accept on the basis of case law.


23 Ibid.
Undoubtedly, the OECD commentaries are important in interpreting tax treaties based on the OECD model convention, but they do not have the force of law in Canada. At most, they are relevant to the extent that they do not represent a major change.24 When such a change does occur, the OECD commentaries can be relevant only for treaties concluded after the change is made. For example, the Tax Court of Canada stated the following in *MIL (Investments) SA v. The Queen*:

Article 31(1)(c) of the Vienna Convention states “there shall be taken into account, together with the context, any relevant rules of international law applicable in the relations between the parties.” I interpret that to mean that one can only consult the OECD commentary in existence at the time the Treaty was negotiated without reference to subsequent revisions. The Respondent’s own expert on cross-examination agreed that subsequent revisions should be ignored:

Q. First, I understand that using the commentaries that came out in 2003 to the OECD Convention, the Article 1 commentaries, I think we both agree that trying to apply those commentaries to interpret a treaty that was put in place in 1989 is nonsense. Would you agree with that?

A. That is correct.

Overall, I found Steichen’s opinion and testimony not substantively convincing. In particular, in light of the OECD commentary and the decision by Canada and Luxembourg not to include an explicit reference to anti-avoidance rules in their carefully negotiated Treaty, I find there is no ambiguity in the Treaty permitting it to be construed as containing an inherent anti-abuse rule. Simply put, the “ordinary meaning” of the Treaty allowing the Appellant to claim the exemption must be respected.25


Subsequent commentaries that elaborate on prior commentaries and are fair interpretations of the articles of the Model may be useful in the interpretive process. However, it is questionable how useful they may be, or what they may add in many cases when the articles of the treaty are interpreted in accordance with Article 31 of the *Vienna Convention*, with the aid of prior commentaries in accordance with the principles of logic and good sense. . . . We also are of the view that later commentary contradicting previous commentary should never be taken into account in interpreting existing treaties. To do so would be to deny the effectiveness of existing OECD commentary as part of the legal context in establishing the intentions of the parties negotiating particular tax treaties based on the commentaries and the Model current at the time and to delegate to the CFA an international law-making capacity for which there is no support. In short, later commentaries that go beyond a fair interpretation of the text of the particular treaty should be given little or no weight by national courts dealing with the interpretation and application of pre-existing treaties. [Emphasis added.]

25 *MIL (Investments) SA v. The Queen*, 2006 TCC 460, at paragraphs 86-87; aff’d. 2007 FCA 236.
Subsequently, in *Prévost Car Inc. v. Canada*, the Federal Court of Appeal stated that

> [t]he worldwide recognition of the provisions of the Model Convention and their incorporation into a majority of bilateral conventions have made the Commentaries on the provisions of the OECD Model Convention a widely-accepted guide to the interpretation and application of the provisions of existing bilateral conventions (see *Crown Forest Industries Ltd. v. Canada* ... [1995] 2 S.C.R. 802 (S.C.C.). . . .

The same may be said with respect to later Commentaries, when they represent a fair interpretation of the words of the Model Convention and do not conflict with Commentaries in existence at the time a specific treaty was entered and when, of course, neither treaty partner has registered an objection to the new Commentaries. . . .

I therefore reach the conclusion, that for the purposes of interpreting the Tax Treaty, the OECD Conduit Companies Report (in 1986) as well as the OECD 2003 Amendments to the 1977 Commentary are a helpful complement to the earlier Commentaries, insofar as they are eliciting, rather than contradicting, views previously expressed. Needless to say, the Commentaries apply to both the English text of the Model Convention (beneficial owner) and to the French text (bénéficiare effectif).26

In *Sommerer v. The Queen*,27 the Tax Court similarly rejected the Crown’s reliance on the 2003 version of the commentary on article 1 of the OECD model. The court accepted the argument that only the 1977 commentary could be taken into account because the 2003 commentary conflicted with the earlier version. This position is based on the Federal Court of Appeal’s remarks in *Prévost* concerning the use of subsequent OECD commentary.28

The 2003 commentary to article 1 regarding the consistency of domestic anti-abuse rules and treaty obligations arguably represents a major change to prior OECD commentary and should thus be relevant only for bilateral treaties subsequently negotiated. I develop this proposition in the next section of this article.

**OECD Commentaries and Reports Prior to the 2003 Commentary**

The OECD commentaries, as well as statements made in two OECD reports, are of central importance in assessing whether the proposals will breach approximately 81 of Canada’s tax treaties in effect prior to the 2003 commentary.29 A comprehensive review of the OECD commentaries and relevant reports prior to the 2003 commentary is beyond the scope of this article.30 The following summary is intended only to demonstrate that the OECD position articulated during this period clearly supported pacta sunt servanda and the need to negotiate treaty amendments. More particularly,
it is clear that the OECD commentaries and reports prior to the 2003 commentary supported treaty amendments to address perceived treaty abuse, and in no way recommended that countries adopt domestic legislation to deny treaty benefits under treaties that were in force prior to the commentary.

The provisions of the 1977 OECD model convention deal with the conduit situation in a rudimentary way, expressing only a general concern that the improper use of treaties should be avoided. The conduit company report adopted by the OECD Council on November 27, 1986 briefly elaborates on this position at paragraph 43, stating that treaty benefits must be granted in the absence of any clauses with safeguards against the use of their provisions. The conduit company report further recommends that countries be prepared to provide all possible help by exchanging information and to remedy such a situation by adequately revising the particular treaty. This position is treated in more detail in the OECD’s subsequent tax treaty override report. That report defines a treaty override as “a situation where the domestic legislation of a State overrules provisions of either a single treaty or all treaties hitherto having had effect in that State.” The tax treaty override report strongly urges member countries to avoid any legislation “intended by the legislature to have effects in clear contradiction to international treaty obligations.” Thus, the intention of the legislature is the primary element in the OECD’s decision to censure a treaty override. To clarify this subjective element, the tax treaty override report cites three examples of situations that involve or are similar to a treaty override but that are distinguishable and not the subject of the report. Although the report explicitly “recognize[s] the legitimacy of the objective pursued,” it says that the denial of treaty benefits must be done under existing rules. It suggests that this type of case might be the object of a mutual agreement procedure, and that the OECD Fiscal Affairs Committee remains strongly opposed to treaty overrides. Paragraph 34 of the tax treaty override report, adopted by the OECD Council on October 2, 1989, states that

[the Committee has considered the arguments that might be put forward to defend the use of overriding legislation and recognised that in a number of cases the legitimacy of the objective pursued—in particular where they aim at counteracting abuse of

33 Ibid., at paragraph 2.
34 Ibid., at paragraph 5.
35 Ibid., at paragraph 34.
36 On the basis of this report, many of the provisions of ITCIA would not be considered a “treaty override.” The proposals are significantly different in nature from other provisions of ITCIA (other than GAAR).
conventions—is well founded but the Committee remains strongly opposed to over-
riding legislation. Member countries have so far refrained from taking retaliatory
measures (which all agree would not be conducive to better understanding in the
international tax field) against overriding legislation but the Committee noted that
there is growing dissatisfaction with the continued use of such legislation which could
erode confidence in the international tax treaty network as a whole.37

In 1992, the commentary to article 1 of the OECD model convention was modified
in response to concerns about the “improper” use of tax conventions. Paragraph 7
of the 1992 commentary provides that double tax conventions should not help tax
avoidance, but notes that

it is for the States concerned to adopt provisions in their domestic laws to counter such
manoeuvres [to exploit the differences in tax levels as between States and the advan-
tages provided by various countries’ taxation laws]. Such States will then wish, in their
bilateral double taxation conventions, to preserve the application of provisions of this kind
contained in their domestic laws.38

Finance seemingly did not respond to this commentary by expressly preserving the
application of the general anti-avoidance rule (GAAR) in its tax treaties that entered
into force prior to the 2003 commentary.

The 1992 commentary suggests in paragraph 10 that some of these situations are
dealt with in the convention by the introduction of the concept of “beneficial
owner” in articles 10, 11, and 12 or other provisions. It also indicates that

[i]t may be appropriate for Contracting States to agree in bilateral negotiations that any
relief from tax should not apply in certain cases, or to agree that the application of the
provisions of domestic laws against tax avoidance should not be affected by the Convention.39

Paragraph 11 of the 1992 commentary indicates that the concern about the use
of conduit and base companies to obtain treaty benefits not intended by the contract-
ing states in their bilateral negotiations “has led an increasing number of Member
countries to implement treaty provisions (both general and specific) to counter abuse
and to preserve anti-avoidance legislation in their domestic laws” (emphasis added). Paragraph 12 of the 1992 commentary indicates only that

several solutions have been considered [to address the treaty-shopping problem] but,
for the reasons set out in the above-mentioned reports, no definitive texts have been
drafted, no strict recommendations as to the circumstances in which they should be

37 Tax treaty override report, supra note 32, at paragraph 34.
38 Paragraph 7 of the commentary to article 1, adopted by the OECD on July 23, 1992 (emphasis
added).
39 Ibid., at paragraph 10 (emphasis added).
applied [have been] made [and no] exhaustive list of such possible counter-measures [has been] given. The texts quoted below are merely intended as suggested benchmarks that treaty negotiators might consider when searching for a solution to specific cases.40

The 1992 commentary then outlines several possible approaches to be considered.

**CANADA’S TREATY POLICY PRIOR TO THE 2003 COMMENTARY**

Canada's treaty policy prior to the 2003 commentary is also an important factor in assessing whether the proposals would breach Canada's international treaty obligations. In this part of the article, I demonstrate that an anti-treaty-shopping policy of Finance first found expression only in 1993, while the Canada Revenue Agency (CRA) issued favourable tax rulings for 20 years thereafter. Indeed, Finance appears to have overlooked its own behaviour prior to the 2003 commentary and CRA rulings practice in formulating its conclusion that there will be no conflict with treaties. To the contrary, Finance and the CRA arguably facilitated treaty shopping.

**GAAR**

Compelling evidence that Canada has not historically had an anti-treaty-shopping policy is apparent in the history of GAAR,41 which was enacted in 1988. The provision, as enacted, was expressly applicable only to a misuse or abuse of the Income Tax Act.42 No reference was made to tax treaties in the legislation, in any government explanatory note, or in the CRA information circulars.

It is likely that the reason for this absence of concern in the 1970s and 1980s was that treaty shopping into Canada was not very lucrative, given the high Canadian treaty rates compared with the 25 percent Canadian statutory withholding rates. The treaty-reduced rates negotiated in the mid-1980s and thereafter, not to mention certain exemptions, changed the financial incentives for investors and the cost to the Canadian government. Specifically, the changes to Canada's tax treaties, especially the treaties with the Netherlands and Luxembourg, meant that non-residents could profit from treaty shopping more than they had in the past.

It is perhaps not surprising, therefore, that it was not until 1993 that the CRA stated that it might seek to apply GAAR to treaty shopping,43 which precipitated a

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40 Ibid., at paragraph 12 (emphasis added).
42 RSC 1985, c. 1 (5th Supp.), as amended.
debate about whether GAAR could apply to the abuse of a tax treaty.\textsuperscript{44} In this respect, the technical explanation of the third protocol introduced in 1995 to the Canada-US treaty stated that the limitation-on-benefits (LOB) article is not reciprocal and that “Canada prefers to rely on general anti-avoidance rules to counter arrangements involving treaty-shopping through the United States.” The fourth protocol (effective March 28, 1984) had a unidirectional LOB provision that could permit the United States, but not Canada, to deny treaty benefits. The fourth protocol provided as follows:

It is understood that the fact that the [LOB] provisions of this Article apply only for the purposes of the application of the Convention by the United States shall not be construed as restricting in any manner the right of a Contracting State [Canada] to deny benefits under the Convention where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of the Convention.\textsuperscript{45}

The debate about the relationship between GAAR and tax treaties was ultimately resolved by a 2005 amendment to the Income Tax Act, retroactive to 1988, that expressly made GAAR applicable to a misuse or abuse of a tax treaty. At the same time, ITCIA was amended, retroactive to 1988, to provide that GAAR applies notwithstanding any treaty provisions to the contrary.\textsuperscript{46} Yet the new anti-treaty-shopping policy from the early 1990s was not reflected in subsequent tax treaties or in the CRA’s rulings practice. In particular, after issuing statements about GAAR and treaty shopping in the early 1990s, the CRA issued a series of advance income tax rulings on the investment by Luxembourg and Netherlands corporations into Canada and the favourable capital gains provision in article XIII.\textsuperscript{47} This practice clearly demonstrates the detrimental reliance that taxpayers and advisers placed on a common understanding of treaties and administrative practice.

Although there are many deletions in the published rulings, there is no evidence, including caveats, that suggest that treaty shopping was of concern. In addition, the use of third-country conduits arose in respect of the fifth protocol to the Canada-US tax treaty because of the hybrid entity rules. In the CRA round table at the 2009 annual

\textsuperscript{44} Tremblay, supra note 41.

\textsuperscript{45} Protocol Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital signed at Washington on September 26, 1980 as amended by the protocols signed at Ottawa on June 14, 1983 and March 28, 1984, article 18, new article XXIX A(7).

\textsuperscript{46} ITCIA was introduced in 1984 and has been amended on numerous occasions to deal with various treaty interpretation matters, particularly when the government lost a case dealing with treaty interpretation. ITCIA was introduced to reverse the decision of the Supreme Court of Canada in \textit{The Queen v. Melford Developments Inc.}, 82 DTC 6281 (SCC). That case dealt with the ambulatory definition of an undefined term in the Canada-Germany treaty.

\textsuperscript{47} See, for example, CRA document nos. 2000-0015753, 2000; 2005-0144481E5, December 4, 2007; 2009-0343641R3, 2009; 9506785, August 29, 1995; and 9609153, 1996.
tax conference, question 4 addressed an increase in the paid-up capital of an unlimited liability company (ULC). In response, the CRA stated that it would not normally expect GAAR to apply under certain conditions. Question 5 dealt with interposing a Luxembourg SARL (société à responsabilité limitée) to obtain relief under the Canada-Luxembourg treaty. The CRA stated that the comments regarding GAAR in response 4 applied. In 2009, the CRA issued a favourable tax ruling on the interposition of a Netherlands company between a ULC and its US parent. These responses and the ruling facilitated the use of treaties in a manner that Finance now says is offensive. At the 2013 International Fiscal Association meeting, the CRA announced that taxpayers should not expect Rulings to look favourably on a ruling request involving the interposition of an entity located in a third jurisdiction to avoid the application of article IV(7) of the Canada-US treaty.

As is well known, the government was unsuccessful in using GAAR and arguing that there was an inherent anti-abuse rule in the Canada-Luxembourg treaty to challenge treaty shopping in MIL (Investments) SA v. The Queen. MIL involved the redomiciling of a Cayman corporation to Luxembourg in order to use the convention to avoid Canadian tax on a capital gain. In regard to the justification for the proposals, Finance seems not to think that this case refutes any suggestion that the proposals do not conflict with the 2003 commentary. In MIL, the Tax Court said the following:

Abusive Avoidance under the Treaty

Having found that the Sale and none of the transactions in the Series are avoidance transactions, it is not necessary for me to analyze whether any of those transactions is abusive under subsection 245(4). If I were to do such an analysis, however, I would focus on whether a specific provision or article of the Treaty or Act was misused or abused. In the Appellant’s case, I would consider specifically, the exemptions relied upon by the Appellant in Article 13(4).

An example of potential abuse can be found in RMM Canadian Enterprises Inc. v. MNR, 97 DTC 302. There, the Appellant attempted to structure a “surplus-stripping” transaction as a capital gain in order to have an exemption pursuant to Article XIII of the Canada-US treaty as opposed to a dividend which would be treated less favourably under Article X. In such circumstances, it would not necessarily be unreasonable to apply section 245 to recharacterize the capital gain as a dividend for the purposes of denying the Treaty benefit.

In written argument, Respondent’s counsel argued that “treaty shopping” is an abuse of bilateral tax conventions and that this is recognized by the Supreme Court of Canada. In oral argument, the following passage from Crown Forest Industries Ltd. v. The Queen . . . [1995] 2 S.C.R. 802, at page 825, was quoted to establish that if the Supreme

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51 MIL (Investments) SA, supra note 25.
Court had access to section 245, it would have used that section to deny a benefit from “treaty shopping”:

“It seems to me that both Norsk and the respondent are seeking to minimize their tax liability by picking and choosing the international tax regimes most immediately beneficial to them. Although there is nothing improper with such behaviour, I certainly believe that it is not to be encouraged or promoted by judicial interpretation of existing agreements. . . .”

I do not agree that Justice Iacobucci’s obiter dicta can be used to establish a prima facie finding of abuse arising from the choice of the most beneficial treaty. There is nothing inherently proper or improper with selecting one foreign regime over another. Respondent’s counsel was correct in arguing that the selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the use of the selected treaty that must be examined.

Canada has negotiated a broad network of carefully negotiated tax conventions with many different nations. Prior to negotiating the Treaty, Canada undoubtedly had knowledge of Luxembourg’s treatment of capital gains.52

This reasoning clearly provides support for the position that the proposals would breach all of the pre-2003 commentary treaties.53 Although the post-2003 commentary does not expressly refer to GAARS, it is understood that such a reference is not considered necessary for treaties negotiated thereafter.54 But it remains an open question whether these treaties will nevertheless be breached by the proposals, which, it is submitted, are inconsistent with the 2003 commentary.

It is notable that Canada has included in approximately 16 more recent tax treaties a “main purpose” test similar to that in the proposals in order to deny access to treaty benefits in specific articles. For example, article 12(7) of the recent Canada-Hong Kong treaty provides that

[a] resident of a Party shall not be entitled to any benefits provided under this Article in respect of a royalty if one of the main purposes of any person concerned with an assignment or transfer of the royalty, or with the creation, assignment, acquisition or transfer of rights in respect of which the royalty is paid, or with the establishment, acquisition or maintenance of the person that is the beneficial owner of the royalty, is for that resident to obtain the benefits of this Article.55

52 Ibid., at paragraphs 70-73 (TCC).
53 The government also attempted to challenge treaty shopping on the basis of “beneficial ownership” in Prévost Car Inc., supra note 26, and Vébro Canada Inc. v. The Queen, 2012 TCC 57. In neither case was GAAR argued. The government lost in both Prévost and Vébro.
54 See Arnold, supra note 22.
55 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, signed at Hong Kong on November 11, 2012.
In regard to treaties negotiated after 2003, it is clear that the 2003 commentary on article 1 is entirely focused on domestic rules that determine the facts that give rise to a tax liability. The proposals appear to be crafted so as to determine the facts as contemplated without reference to an object-and-spirit or other purpose test.\(^{56}\) The CRA takes the position that a main purpose test is a question of fact to be determined objectively.\(^{57}\) This view was recently supported by the Federal Court of Appeal in *Groupe Honco Inc. v. Canada*.\(^{58}\) However, as David Ward noted, a domestic rule that determines facts is not a mandate for the wholesale overriding of tax treaties.\(^{59}\)

**Comments on Specific Tax Treaties and Observations to the 2003 Commentary**

The Canada-Netherlands treaty (signed on May 27, 1986 and amended by the protocols signed on March 4, 1993 and August 25, 1997) and the Canada-Luxembourg treaty (signed on September 10, 1999) warrant comment because of their widespread use in planning and their honourable mention in the consultation paper, not to mention the comments made in *MII Investments* concerning the Luxembourg treaty.

Neither treaty mentions tax avoidance or abuse, and hence there is no object-and-spirit test in either treaty that lends itself to a GAAR challenge. In fact, the generous capital gains provisions of both treaties do not even follow the OECD model convention, and they further diminish Finance’s claims regarding the 2003 commentary. One can reasonably conclude that the treaties, and especially article XIII, were negotiated by Finance to facilitate foreign investment in Canada by residents of third states. These treaties have been enormously successful in that respect. In regard to article XIII, the domestic law of the Netherlands and Luxembourg would impose tax on a capital gain realized by a Canadian tax resident in very limited circumstances in comparison with the “taxable Canadian property” rules in the Income Tax Act (and this was particularly the case at the time the treaties were negotiated).

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\(^{56}\) In contrast, GAAR does not determine facts or recharacterize transactions per se. Both the Income Tax Act and the jurisprudence on this point are clear: section 245 “does not permit the recharacterization of an event for purposes of determining whether s. 245(2) applies. Recharacterization is permissible under s. 245(5)(c) only where it can be found that s. 245(2) applies on the basis of transactions which have not been subjected to recharacterization”: *Canadian Pacific Limited v. The Queen*, 2000 DTC 2428, at paragraph 10 (TCC); aff’d. 2002 DTC 6742 (FCA).


\(^{58}\) *Groupe Honco Inc. v. Canada*, 2013 FCA 128.

It is inconceivable that the intention of the parties in these two treaties was that
treaty entitlements for the indeterminate term of the treaty should be based on a
unilateral approach taken by Canada as much as 30 years later in the case of the
Netherlands treaty and 15 years in the case of the Luxembourg treaty. The com-
ments on prevailing OECD commentary and other factors buttress this conclusion.

The Netherlands treaty was apparently renegotiated at the behest of the US gov-
ernment to curtail double dipping into the United States.\(^{60}\) If Finance had any
concern about inbound treaty shopping, it would have negotiated a very different
treaty. (It had included a specific anti-avoidance provision in the 1978 Canada-UK
treaty).\(^{61}\) Finance was presumably very familiar with the US use of LOB provisions to
curtail treaty shopping but had no interest in the US approach or other treaty-based
anti-avoidance rules. The Luxembourg treaty is more recent but also entered into
force before the 2003 commentary and after statements from the CRA concerning
GAAR.

Recent attempts to use the Access to Information Act to obtain information about
the negotiation of these two tax treaties and treaty abuse were unsuccessful.\(^{62}\) It may
be that Finance either was not aware of or chose to disregard the observation made
by each of Luxembourg and the Netherlands in respect of the 2003 commentary:

27.6 Luxembourg does not share the interpretation in paragraphs 9.2, 22.1 and 23
which provide that there is generally no conflict between anti-abuse provisions of the
domestic law of a Contracting State and the provisions of its tax conventions. Absent
an express provision in the Convention, Luxembourg therefore believes that a State
can only apply its domestic anti-abuse provisions in specific cases after recourse to the
mutual agreement procedure.

27.7 The Netherlands does not adhere to the statements in the Commentaries that as
a general rule domestic anti-avoidance rules and controlled foreign companies provi-
sions do not conflict with the provisions of tax conventions. The compatibility of such
rules and provisions with tax treaties is, among other things, dependent on the nature
and wording of the specific provision, the wording and purpose of the relevant treaty

\(^{60}\) See Vivien Morgan, “The Pending Canada-Netherlands Tax Treaty: The Dutch Treat Is

\(^{61}\) Convention Between the Government of Canada and the Government of the United Kingdom
of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the
Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed at
London on September 8, 1978, article 11(10).

\(^{62}\) Tax Policy Branch officials advised that information dealing with the negotiation of treaties is
highly sensitive and would not be released as part of an access-to-information request in respect
of any combination of the following provisions of the Income Tax Act: paragraph 13(1)(a)
(information obtained in confidence from the government of a foreign state or an institution
thereof) and paragraph 15(1)(g) (on the positions adopted or to be adopted by the government
of Canada, governments of foreign states, or international organizations of states for the
purpose of present or future international negotiations).
provision and the relationship between the domestic and international law in a country. Since tax conventions are not meant to facilitate the improper use thereof, the application of national rules and provisions may be justified in specific cases of abuse or clearly unintended use. In such situations the application of domestic measures has to respect the principle of proportionality and should not go beyond what is necessary to prevent the abuse or the clearly unintended use.

The relevance of an observation is that these countries do not share the views stated in the interpretation of the Commentary. It is axiomatic that any interpretation in the commentaries will not apply if the negotiating party did not intend the Commentary to be used as a basis for interpretation. Their observations undisputedly refute any suggestion that the Proposals do not conflict with the Netherlands Convention and Luxembourg Convention because of the 2003 Commentary.63

Obviously, these tax treaties do not reflect Finance’s current treaty-shopping policy. Nevertheless, dissatisfaction with a thoroughly negotiated treaty is hardly a reason for Canada to unilaterally propose rules that will restrict treaty benefits that would have been unimaginable when the treaties entered into force. Canada’s duty to comply with these (and other) treaties is unequivocal, especially in view of the observations on the 2003 commentary.

THE RANKING OF TAX TREATIES IN CANADIAN LAW

The question arises whether a breach of tax treaties by Canada is unlawful in Canada. In Canada, tax treaties provide that the treaty does not come into force until it is ratified by the states that have signed it. Once the tax treaty is in force, the parties are obligated under international law to implement the treaty. Canada does not recognize a treaty as part of its domestic law. Consequently, a treaty that requires a change in domestic legislation can be implemented only by the enactment of a statute. This is the case with tax treaties. Many countries share this dualist approach, but others do not. For example, the US constitution makes all treaties part of the supreme law of the land. Treaties are equal in standing to regular laws. The general rule in the United States is that the provision that is later in time governs.

It is clear that the proposals, when enacted, will not be unconstitutional in Canada. The courts will apply Canadian statutory or common law even if it is inconsistent with a binding treaty. A leading Canadian constitutional law expert has said that

[i]n a case where Canada’s internal law is not in conformity with a treaty binding upon Canada, then Canada is in breach of its international obligations and may be liable in international law to pay damages or suffer other sanctions, but the breach of a treaty is irrelevant to the rights of parties to litigation in a Canadian court. The only concession which the Canadian courts have been prepared to make in recognition of Canada’s international obligations is to interpret statutes so as to conform as far as

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63 Paragraphs 27.6 and 27.7 of the 2003 commentary on article 1, supra note 8 (emphasis added).
possible with international law. But where the language of a statute is clearly and un-
mistakably inconsistent with a treaty or other rule of international law, then there is
no room for interpreting it into conformity with the international rule and the statute
must be applied as it stands.\(^\text{64}\)

Accordingly, even if legislation enacting the proposals clearly breaches a particu-
lar treaty, a Canadian court must apply the legislation (assuming that it is clearly
drafted). However, just because Finance can propose domestic legislation that is
lawful in Canada but breaches treaty obligations does not mean that it should do so.

Interestingly, some enacting legislation gives paramountcy to tax treaties. For
example, the implementing legislation for the Canada-US treaty (assented to in
1984) and for the Canada-Netherlands treaty provides as follows:

In the event of any inconsistency between the provisions of this Act or the Conven-
tion, and the provisions of any other law, the provisions of this Act and the Convention
prevail to the extent of the inconsistency.\(^\text{65}\)

The implementing legislation does not refer to ITCA. The fact that certain treaties
prevail in the event of inconsistency makes it spurious to suggest that the proposals
will not violate tax treaties when the implementing legislation has this paramountcy
provision. It is expected that Finance will want to amend such implementing legis-
lation to provide for paramountcy of ITCA.

The enacting legislation for many tax treaties provides that ITCA has paramount-
cy in the case of any inconsistency. For example, the legislation that implemented
the Canada-Slovenia treaty provides as follows:

5.(1) Subject to subsection (2), in the event of any inconsistency between the provi-
sions of this Part or the Convention and the provisions of any other law, the provisions
of this Part and the Convention prevail to the extent of the inconsistency.

(2) In the event of any inconsistency between the provisions of the Convention
and the provisions of the Income Tax Conventions Interpretation Act, the provisions of
that Act prevail to the extent of the inconsistency.\(^\text{66}\)

The same wording is used in the legislation that implements many other tax treat-
ies, including the Canada-Luxembourg treaty.

A treaty override may present alternative remedies to the other state if the other
state is sufficiently concerned. Such remedies could include filing a protest or, at the
draconian worst, cancelling the treaty.\(^\text{67}\) The latter was strongly discouraged in the

\(^{64}\) Peter W. Hogg, Constitutional Law of Canada, 5th ed. (Toronto: Thomson Canada, 2007), at
11-7 to 11-8.

\(^{65}\) Canada-United States Tax Convention Act, 1984, SC 1984, section 3(2).


\(^{67}\) Li and Sandler, supra note 19, at 895.
OECD tax treaty override report. The taxpayer that is denied treaty benefits because of a treaty override is in a difficult position. The taxpayer is not a party to the tax treaty and cannot succeed in contesting an assessment on the basis of Canada’s contravention of the treaty, assuming that the treaty override legislation is clearly drafted.

**OECD DISCUSSION DRAFT**

The OECD discussion draft on treaty shopping is the result of work focused on the following areas identified by BEPS Action 6:

1. treaty provisions and/or domestic rules to prevent the granting of treaty benefits in inappropriate circumstances;
2. clarification that tax treaties are not intended to be used to generate double non-taxation; and
3. tax policy considerations for countries to consider before deciding to enter into a tax treaty with another country.

The discussion draft distinguishes between (1) cases where a person tries to circumvent limitations imposed by the treaty itself, and (2) cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits. The discussion draft treats treaty shopping as case 1 and suggests that countries adopt a treaty-based approach in response, with a main article based on a US-style comprehensive LOB clause supplemented by a more limited purpose-based article.

Endorsement of a domestic-law approach in curtailing treaty shopping is conspicuously absent. If that was a preferred approach, one would have expected a detailed discussion. In fact, note 12 in the discussion draft states that

[u]nder the principles of public international law, as codified in Articles 26 and 27 of the Vienna Convention on the Law of Treaties . . . , if the application of a domestic anti-abuse rule has the effect of allowing a State that is party to a tax treaty to tax an item of income that that State is not allowed to tax under the provision of the treaty, the application of the domestic anti-abuse rule would conflict with the provisions of the treaty and these treaty provisions should prevail.68

It is impossible to reconcile the proposals with the discussion draft. Like others, I have questioned why Finance did not wait for the release of the discussion draft before releasing the proposals, and why the proposals seem fundamentally inconsistent with the recommendations in the discussion draft. Because of the lack of any requirement of a finding of abuse, the proposals are broader than both GAAR and the approach of the discussion draft, which in paragraph 8 proposes the denial of a

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68 Discussion draft, supra note 9, at note 12. This was pointed out by Steve Suarez, supra note 10.
treaty benefit “unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provision of the Convention.” Ironically, Finance also chose to reject the comments in the 2003 commentary in respect of “object and purpose,” notwithstanding that Finance quoted them in its consultation paper:

A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.69

Perhaps Finance wishes to avoid an object-and-purpose test, given the reasoning and result in the MIL decision. Finance may also object to the possibility that the government may bear the onus to establish object and purpose in the face of clear treaty language and the absence of any Canadian anti-treaty policy at the time of the particular treaty. The OECD discussion draft is superseded by the Action 6 report.

**THE ACTION 6 REPORT**

The explanatory statement for the seven 2014 deliverables stated that the first set of reports and recommendations addresses seven of the actions in the BEPS Action Plan. The proposed measures,

while agreed, are not yet formally finalised as they may be impacted by some of the decisions taken with respect to the 2015 deliverables with which they interact. They do reflect consensus on a number of solutions to put an end to BEPS.70

The four reports are in draft, and detailed implementation steps are described in the explanatory statement.

The foreword to the Action 6 report states that BEPS requires a coordinated response but that countries have sovereignty over tax matters and measures may be implemented in different countries in different ways as long as they do not conflict with the international legal commitments of the country. Action 6 required, inter alia, the development of model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. The Action 6 report, like the OECD discussion draft, distinguishes between two cases:

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69 Paragraph 9.5 of the 2003 commentary on article 1, supra note 8 (emphasis added).

1. Cases where a person tries to circumvent limitations provided by the treaty itself.
2. Cases where a person tries to circumvent the provisions of domestic tax law by using treaty benefits.\(^{71}\)

Like the discussion draft, the Action 6 report treats treaty shopping as falling within case 1.\(^{72}\) The Action 6 report recommends a three-pronged approach:

1. include in the title and preamble of tax treaties a clear statement that the contracting states intend to prevent tax avoidance and specifically intend to avoid opportunities for treaty shopping;
2. include in tax treaties a specific anti-abuse rule based on LOB provisions included in treaties concluded by the United States and a few other countries; and
3. in order to address other forms of treaty abuse, including treaty shopping that would not be covered by a LOB provision as described above, include in treaties a more general anti-abuse provision based on the principal purposes of the transactions or arrangements (“the PPT rule”).

The approach in the Action 6 report is the same as that in the OECD discussion draft. Domestic anti-abuse rules were not added as a fourth prong in the Action 6 report. The Action 6 report states that the combination of a LOB provision and the PPT rule may not be appropriate for countries that have domestic anti-abuse rules and that those countries either may not require the general treaty anti-abuse provision or may prefer a more restricted version.\(^{73}\) The Action 6 report states that “[a]s long as the approach that countries adopt effectively addresses treaty abuses along the lines of this report, some flexibility is therefore possible.”\(^{74}\)

The Action 6 report’s recommendations reiterate the three-pronged approach, adding “or domestic anti-abuse rules or judicial doctrines that would achieve a similar result.”\(^{75}\) In this regard, the report seems to endorse a domestic-law approach with surprising brevity, but not as a fourth prong, nor was it mentioned in the explanatory statement. The discussion draft did not endorse this alternative.

In the sections dealing with “[c]ases where a person tries to circumvent the provisions of domestic tax law using treaty benefits,” new paragraphs are added to the commentary on specific legislative anti-abuse rules. The report states that

\(^{71}\) Supra note 6, at 20.
\(^{72}\) Ibid., at 21, paragraph 13.
\(^{73}\) Ibid.
\(^{74}\) Ibid., at 21, paragraph 14.
\(^{75}\) Ibid.
where the application of provisions of domestic law and of those of tax treaties produces conflicting results, the provisions of tax treaties are intended to prevail. This is a logical consequence of the principle of “pacta sunt servanda.”

It is perplexing that pacta sunt servanda is not mentioned in connection with treaty shopping under “[c]ases where a person tries to circumvent limitations provided by the treaty itself.” One might assume that this omission was intentional and that it implies a shared view that a domestic anti-abuse rule in regard to treaty shopping would not contravene the pacta sunt servanda doctrine, provided that the rule was “along the lines” of a LOB provision and the PPT rule. Is that the case just because there was a consensus among members concerning the draft recommendations in the Action 6 report? At this point, it is a matter of speculation whether there will be any more detail regarding a domestic-law approach, which would provide more assistance in assessing any future proposals when the recommendations are finalized.

It is not known whether Finance will release future proposals before the recommendations are finalized.

It is anticipated that Finance may view the Action 6 report as OECD approval for proceeding with the future proposals. However, Finance should draft the future proposals very clearly “along the lines” of the report—namely, the future proposals should be a LOB provision, a PPT rule, or both in order for Finance to claim that it has OECD support. The present proposals cannot reasonably be considered to fit this description.

RECOMMENDATIONS TO RENEGOTIATE TAX TREATIES

The statements in the consultation paper and the 2014 budget about the difficulties in negotiating changes to tax treaties seem exaggerated for several reasons and can hardly constitute a justification for contravening tax treaties. Instead, following a course of seeking treaty amendments, Canada would demonstrate both nationally and internationally that it honours its international treaty obligations notwithstanding any inconvenience, delay, or cost. This approach would strengthen rather than weaken the treaty network. The expenditure of time is a necessary price to pay for treaty compliance.

For several decades, the US Treasury Department has been pursuing the inclusion of a LOB article in both renegotiated and new tax treaties. The objective of limiting the perceived abuse of US tax treaties in the outbound profits distribution context is clear. It is peculiar that the United States, a country often accused of using aggressive treaty overrides, has adopted an effective long-term treaty policy of treaty amendments even though it has the constitutional ability to override treaties. In contrast, Finance seeks to change the fundamental entitlement to treaty benefits in a single amendment to ITCIA.

76 Ibid., at 90, paragraph 5.
The Netherlands has also renegotiated many tax treaties to provide for an anti-avoidance provision in exchange for reduced withholding tax rates. Numerous Dutch tax lawyers have advised me, that on the basis of past practice, they believe that the Dutch finance authorities are open to such a negotiation with Canada. Perhaps the real reason that Canada does not want to pursue treaty amendments is that it would have to make certain concessions to the treaty partner. Even Luxembourg may consider treaty amendments. For example, the Luxembourg-Russia treaty has an anti-avoidance provision:

It is understood that a resident of a Contracting State shall not be entitled to a reduction of or exemption from taxes provided for in this Convention on income derived from the other Contracting State if, as a result of consultations between the competent authorities of both Contracting States, it is established that the main purpose or one of the main purposes of the creation or existence of such resident was to obtain the benefits of this Convention which would otherwise not be granted.

77 The Netherlands treaties and provisions are as follows: Armenia, signed on October 31, 2001 (main purpose test in protocol, article XII(3)); Bahrein (LOB clause, article 10(11)); Barbados (LOB clause, articles 31(1) and (2)); China, 2013 (not yet in force; article 23 will most likely contain a provision that allows the states to enforce their domestic anti-abuse rules notwithstanding the treaty provisions); Croatia, signed on May 23, 2000 (main purpose test, article 10(9)); Egypt, signed on April 21, 1999 (main purpose test, article 10(4)); Estonia, signed on March 14, 1997 (main purpose test, articles 11(8) and 12(7)); Germany (not yet in force; article 23(1) will most likely contain a provision that allows the states to enforce their domestic anti-abuse rules notwithstanding the provisions of the treaty (the main German national anti-abuse rules are article 42 of the German Tax Law [anti-abuse-of-law provision; fraus legis], article 50d(3) of the Income Tax Law [anti-treaty-shopping provision], and chapters 4, 5, and 7 of the External Tax Relations Law); Hong Kong (LOB clause, article 27(3), redirects to anti-avoidance rules in the Dutch national law); Japan, signed on March 3, 1970 (LOB clause, article 21); Jordan, signed on October 31, 2006 (main purpose test, article 10(3)); Kazakhstan, signed on April 24, 1976 (main purpose test in protocol, article XI(2)); Kuwait, signed on May 29, 2001 (LOB clause in protocol, article 5); Latvia, signed on March 13, 1994 (main purpose test, article 10(8)); Macedonia, signed on September 11, 1998 (LOB clause in protocol, article V); Malta (main purpose test in protocol, article IV(1)); Mexico, signed on September 27, 1993 (main purpose test, articles 11(8) and 12(7)); Morocco, signed on August 12, 1977 (main purpose test, articles 11(7) and 12(7)); Panama (LOB clause, articles 10(3)-(6)); Qatar (main purpose test, article 10(7)); Romania, signed on March 5, 1998 (main purpose test, article 10(7)); South Africa, signed on October 10, 2005 (main purpose test, article 10(8)); Suriname, signed on December 1, 1975 (main purpose test, article 102(a)); Switzerland, signed on November 12, 1951 (main purpose test in protocol, article 8); Tunisia, signed on May 16, 1995 (main purpose test, articles 8(3)); United Arab Emirates (main purpose test, article 10(9)); United Kingdom (main purpose test, articles 10(3), 11(5), 12(5), and 20(4)); United States, signed on December 18, 1992 (LOB clause, article 26); and Uzbekistan, signed on October 12, 2001 (main purpose test, articles 11(6) and 12(6)).

78 In particular, I would like to thank Mark van Casteren of Loyens & Loeff for his assistance.

If treaties were renegotiated with a relatively small number of countries that have both a favourable domestic tax regime and a tax treaty with Canada, a great deal of treaty shopping into Canada would be curtailed. From a practical perspective, in other words, it is reasonable to conclude that significant progress may be made more quickly than Finance suggests, albeit perhaps with some withholding tax concessions and the provision of transitional relief.

Finance’s assertion that other conduit countries would emerge is ambiguous. Presumably, Finance is referring to countries with which Canada has current tax treaties. For new treaties, conduits can easily be addressed as Canada has done in recent tax treaties. If a current treaty partner decides to facilitate a conduit by making its domestic legislation much more favourable, a number of options are open to Finance—including terminating the treaty in the worst-case scenario.

**CONCLUSION**

Canada should honour its obligations under its tax treaties. To do otherwise would be a radical and irreversible step with an incalculable effect. The rationale offered by Finance to explain why the proposals did not conflict with tax treaties was untenable. Contrary to Finance’s statements in the consultation paper, the proposals were not even consistent with the recommendations expressed in the OECD discussion draft and the Action 6 report. It remains to be seen whether future proposals will be “along the lines” of the Action 6 report, and whether they will override tax treaties—especially treaties that were in force before the 2003 commentary—in a broad and fundamental manner. Canada could achieve its objectives of curtailing treaty shopping through treaty amendments, as other counties have done; however, the stage is set for a domestic rule with support from the OECD and the G20. It is hoped that the future proposals honour pacta sunt servanda.