Policy Forum: Editor’s Introduction—
Addressing Treaty Shopping

Treaty shopping is part of the Organisation for Economic Co-operation and Development (OECD) project on base erosion and profit shifting (BEPS).\(^1\) On March 14, 2014, the OECD released a public discussion draft\(^2\) on the issue, which was followed by a finalized report and a set of recommendations released on September 16, 2014 after a period of consultation.\(^3\) The Department of Finance has been ahead of the OECD on this particular subject: it released a consultation paper on August 12, 2013,\(^4\) followed by a detailed description of a proposed anti-treaty-shopping rule in the February 11, 2014 federal budget.\(^5\) The proposed rule has proved contentious for two reasons: (1) it is a domestic rule rather than an article to be incorporated in selected treaties, and (2) it is formulated as a “one of the main purposes” test modified by a set of rebuttable presumptions.

The Department of Finance appears to be on an accelerated timeline with its anti-treaty-shopping project, although it recently expressed a willingness to wait for the final OECD BEPS report on the subject before proceeding further.\(^6\) Finance apparently undertook its project because of its dissatisfaction with the judicial reasoning in three treaty-shopping cases;\(^7\) however, its relative haste in issuing the proposed rule before the publication of the OECD’s recommendations is difficult to understand. Earlier this year, on the premise that there was sufficient time to provide some input into Finance’s consultative process, the Canadian Tax Foundation held a seminar on treaty shopping. Finance then released a detailed description of its

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\(^4\) Canada, Department of Finance, *Treaty Shopping—The Problem and Possible Solutions* (Ottawa: Department of Finance, August 2013).


\(^7\) Velcro Canada Inc. v. The Queen, 2012 TCC 57; Canada v. Prévost Car Inc., 2009 FCA 57; and MIL (Investments) SA v. The Queen, 2006 TCC 460; aff’d. 2007 FCA 236.
proposed anti-treaty-shopping rule in the 2014 budget (barely one week after the Foundation’s seminar), indicating that departmental thinking had progressed relatively quickly past the formative stage of consultation. Because treaty shopping has commanded so much recent policy attention in Canada and internationally, we thought it worthwhile to present some of the seminar participants’ deliberations as articles for this feature. In these articles, three of the participants discuss the experiences of some other jurisdictions in addressing treaty shopping. In addition, a senior Canadian tax practitioner critiques Finance’s preferred approach of enacting a domestic anti-treaty-shopping rule.

In the first article, Ken Snider argues that Finance’s proposed rule would constitute an override of the Canadian tax treaties that were concluded before certain changes were made in 2003 to the commentary on article 1 of the OECD model treaty. Snider recommends that Finance abandon the proposals in favour of renegotiation of a select set of bilateral treaties to include an anti-treaty-shopping article. He suggests that Finance’s concerns about this particular approach, as emphasized in both the consultative paper and the 2014 budget, are overstated. He also wonders why, until very recently, Finance had chosen to proceed without waiting for the OECD’s final recommendations on treaty shopping, especially given the somewhat different approach reflected in the OECD’s work.

In the second article, Jonathan Schwarz reviews the experiences of the United Kingdom and the European Union with various approaches to treaty shopping. In its 2011 budget, the UK government proposed to introduce domestic legislation intended to deny treaty benefits in certain circumstances. This proposed legislation was subsequently abandoned in favour of the recently enacted UK general anti-avoidance rule (GAAR) to serve the same function. Schwarz notes that this approach arguably constitutes a treaty override and should be rejected in favour of the adoption of specific anti-treaty-shopping articles in UK treaties. His review of the relevant UK case law in a non-GAAR environment suggests that a creative approach to treaty interpretation can be a robust alternative anti-treaty-shopping tool.

In the third article, Patricia Brown describes the historical development of the limitation-on-benefits (LOB) approach used by the US Treasury department to address treaty shopping. She emphasizes the incremental manner in which incorporation of LOB articles in US treaties has unfolded, including the rejection of conceptually simpler, but more factually complex, approaches, such as a “one of the main purposes” test. With respect to recent refinements to the series of objective tests characteristic of the US LOB approach, Brown focuses on the nexus requirement in the exception for publicly traded corporations. She concludes that a US-style LOB article has proved effective against most common forms of treaty shopping, although its effectiveness requires the threat of application of more general judicially developed anti-abuse doctrines. Brown cautions, however, that its utility should not be assessed in terms of an increase in withholding taxes collected by the United States. She believes that the US insistence on the inclusion of a LOB article has proved effective in extracting reciprocal reductions in withholding taxes from its major trading partners, including Canada. She also cautions that the necessary negotiation and renegotiation
process requires the commitment of substantial government resources, and coun-
tries should be aware of the difficult logistics of implementation.

In the fourth article, Graeme Cooper highlights the importance of fundamental policy responses to treaty shopping. He suggests that the silence of the Australian Treasury Department on the subject is most likely attributable to the fact that the incentive to engage in treaty shopping is lessened by the adoption of consistent treatment of cross-border investment irrespective of the investor’s residence in a treaty or non-treaty country. As Cooper observes, this policy position can be justified on the basis of a perceived gain in national welfare and has been implemented across a range of treatments that are commonly the focus of treaty shopping. Cooper also reviews Australia’s use of many of the standard anti-treaty-shopping responses in those areas in which inconsistent treatment is maintained for residents of treaty and non-treaty countries.

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