

---

# The Unthinkable Anathema of Double Non-Taxation: The Relevance and Implications of Foreign Tax Considerations in the Context of Applying GAAR

Angelo Nikolakakis\*

---

**KEYWORDS:** INTERNATIONAL TAXATION ■ ARBITRAGE ■ TREATIES ■ GAAR ■ AVOIDANCE

---

## CONTENTS

Introduction	243
Judicial Pronouncements of Justice Bowman	248
Double Non-Taxation and Inherent Abuse	248
Foreign Tax Considerations in the GAAR Context	274
Foreign Tax Considerations as Causes of Abuse	274
Foreign Tax Considerations as Bona Fide Purposes	286
Incompatibility of GAAR and Treaty Provisions	290
Conclusions	292

---

*It seems to me that [these taxpayers] 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.*

Iacobucci J in *The Queen v. Crown Forest Industries Limited et al.*, 95 DTC 5389, at 5397 (SCC)

## INTRODUCTION

This article addresses the subject of determining the relevance and implications of foreign tax considerations in the context of applying the general anti-avoidance rule (GAAR) in section 245 of the federal Income Tax Act.<sup>1</sup> We begin with the epigraph

---

\* Of Couzin Taylor LLP (allied with Ernst & Young LLP), Montreal (e-mail: angelo.nikolakakis@ca.ey.com).

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

above from the unanimous decision of the Supreme Court of Canada in the *Crown Forest* litigation,<sup>2</sup> which quite neatly and fairly encapsulates the central thesis of this article—namely, that there is “nothing improper” about international tax arbitrage, and that it is incumbent upon our courts to approach such cases with impartiality and an unequivocal respect for both the rule of law and our constitutional separation of powers, striving neither to encourage nor to discourage such behaviour through an overly active judicial interpretation and application of GAAR or other relevant rules and principles.

This thesis will be explored and developed through an examination of a variety of perspectives. Given the dedication of this volume, the main focus will be the perspective of former Chief Justice Bowman, as gleaned from his judicial pronouncements. Other perspectives reflected in this article, either directly or indirectly, will include those of the tax administration (both in Canada and in certain other jurisdictions), the Organisation for Economic Co-operation and Development (OECD), and various commentators, as well as the perspectives that emerge from more basic principles of our private, public, and constitutional law and their historical development. However, space limitations preclude a detailed treatment of materials reflecting these other perspectives.

Before proceeding, it seems appropriate to lay out certain general parameters of the discussion.

First, the discussion will not involve “tax evasion,” as distinguished from “tax avoidance,” on the basis that the former, but not the latter, consists of unlawful conduct, including fraud and other forms of intentional misrepresentation and deception, whether as to the value or character of amounts or as to the purpose or status of relevant transactions, events, instruments, entities, etc. Thus, the operating premise here is factual transparency—on the basis that intentional misrepresentation *is* improper. However, it is also important to distinguish intentional misrepresentation from factual (or legal) uncertainty and disagreement. By this standard, where a taxpayer advances an uncertain tax position, in good faith, this does not constitute tax evasion.

Second, it is important to acknowledge that both the content and the boundaries of concepts such as good faith and what seems to be at the other end of the spectrum—namely, abuse—are inherently uncertain, and that determinations in this regard necessarily and to a considerable extent will have to be impressionistic and subjective. However, that is not to say that such determinations cannot, or should not, be made within the constitutional and institutional parameters of the judicial function and the rule of law. There is jurisprudence on these matters, including with reference to GAAR, in the same line of disputes leading to the Supreme Court of Canada’s decision in *Kaulius*, although in this context they were considered by the Federal Court of Appeal but not pursued before the Supreme Court.<sup>3</sup>

---

2 *The Queen v. Crown Forest Industries Limited et al.*, 95 DTC 5389 (SCC).

3 *Mathew v. Canada*, sub nom. *Kaulius v. The Queen*, 2005 DTC 5538 (SCC); *Kaulius et al. v. The Queen*, 2003 DTC 5644 (FCA).

Third, it is submitted that the supremacy of the legislature should not be confounded with infallibility. Thus, the role of the courts is to apply the law, with independence and impartiality, on the basis of a “unified textual, contextual and purposive” approach to the interpretation and application of the law (as described by the Supreme Court of Canada in *Canada Trustco*),<sup>4</sup> and not to fill true gaps (or, for that matter, to trim “overbreadth”) in cases involving real differences between *legislative purpose* and *legal effect*.<sup>5</sup> However, it is also submitted that a proper understanding of legislative purpose and of the nature, origin, and extent of any gaps between legislative purpose and *technical* legal effect (meaning the legal effect that would prevail without regard to GAAR and other abuse considerations) must be the essential foundation of any GAAR or other abuse determination. It is submitted that this is the fundamental understanding that animates the Supreme Court’s insistence in *Canada Trustco* (as well as in *Kaulius*) that there must be a strong and relatively clear and demonstrable relationship between the Crown’s theory of abuse and the provisions of the Act. Thus, the fact that a particular taxpayer (either alone or in the context of a broader group of taxpayers) is not paying a particular tax (either in Canada alone or in Canada and/or in any other country) is completely un compelling in itself, whether in the context of a technical analysis or an abuse determination. It is just another fact, and it may or may not be an important fact, depending on the context and surrounding circumstances. In brief, it is submitted that there is no operative principle that all income must be taxed somewhere and, therefore, that the presence of non-taxation or even double non-taxation is inherently abusive (or, for that matter, necessarily within the scope of the notion of abuse applicable under GAAR) such that the courts must, or even can, interpret and apply the laws (including GAAR and the laws implementing income tax conventions) with the objective to defeat it. That simply cannot be the *objective* of the courts, and GAAR cannot entitle the judiciary to adopt such an approach, or confer upon them any “wide legislative authority,” as described in *Antle*,<sup>6</sup> if they are to serve the constitutional and institutional function of being independent and impartial arbiters of disputes involving the very question of whether or not tax is legally owing.

---

4 *Canada Trustco Mortgage Co. v. Canada*, 2005 DTC 5523, at paragraphs 41 and 42 (SCC).

5 For an interesting recent example of this principle, see *Exida.com LLC v. The Queen*, 2010 DTC 5101, at paragraph 28 (FCA), where the court makes the following comments: “No doubt this was the intention. As was found by the Tax Court Judge, the legislative history and context make it clear that the intention was to impose the higher of the ‘regular penalties’ and the ‘alternative penalties’ when a non-resident corporation has taxes payable and the higher of the ‘alternative penalties’ when it has none (Reasons, para. 57). However, it is equally clear that those charged with implementing this last aspect of the legislative plan failed in their task. . . . The question which arises in this appeal is whether this fundamental drafting error can be cured by the purposive interpretation proposed by the Tax Court Judge. In my respectful view, it cannot.”

6 *Antle et al. v. The Queen*, 2009 DTC 1732, at paragraph 122 (TCC).

Fourth, and as somewhat of a corollary, it is submitted that there is nothing necessarily improper or inherently abusive about a taxpayer implementing a transaction or engaging in other conduct that lacks economic substance and is simply driven by tax motivation (nor does such a transaction or conduct necessarily constitute a “sham,” an “artificial” or “ineffective” transaction, or “window dressing”). This is acknowledged in a long line of the jurisprudence of the Supreme Court of Canada, including *Canada Trustco*<sup>7</sup> and *Stuart Investments*.<sup>8</sup> We do not, in Canada, have a general “business purpose test”; and, even if we did, it would have to have exceptions, including but not necessarily limited to exceptions for deliberate tax incentives. The economic purpose of having a retirement savings plan is obvious, but it is equally obvious that the singular purpose of registering that plan in accordance with the rules in the Act is to achieve non-taxation (or at least deferral). This is a clear example but it is far from the only one, and others are less clear. Another personal favourite is the use of “squeeze-out shares” in the context of an amalgamation, for the singular purpose of complying with the technical conditions of subsection 87(1) and thereby achieving the non-taxation of various corporate interests in circumstances where, when viewed from the perspective of economic substance, not all of the historical shareholders will remain invested in the continuing corporation. This, too, is a clear example of circumstances in which a lack of economic substance is not problematic—and, indeed, should be and is in fact expected in the context of applying the Act. That this is so is demonstrated by the presence of subsection 87(10), which not only specifically contemplates the use of this technique but does so in the cross-border context, and actually requires that such shares have a very short life expectancy in that they must be cashed out “within 60 days after the amalgamation.” There is also administrative practice in this context, including statements accepting the shifting of paid-up capital onto such shares to prevent a deemed dividend under subsection 84(3).<sup>9</sup> Thus, the significance of a lack of economic substance must depend on the context and surrounding circumstances. It is submitted that any other, dogmatic position in this regard is simply unarguable as a matter of Canadian law, and does not properly reflect the historical development and current state of our constitutional culture—a culture that insists on a strong relationship between the exercise of the power of taxation and democratic representation (as reflected not only in section 53 of the Constitution Act, 1867,<sup>10</sup> but also in the historical precursors to

7 *Supra* note 4, at paragraph 57.

8 *Stuart Investments Limited v. The Queen*, 84 DTC 6305 (SCC).

9 See the example in *Information Circular* 88-2, “General Anti-Avoidance Rule—Section 245 of the Income Tax Act,” October 21, 1988, supplement 1, paragraph 9. See also CRA document no. 2001-0079595(E), May 10, 2001, concerning paid-up capital shifts to restore a non-resident’s contribution, as well as CRA document no. 9635243(E), January 1, 1996, concerning paid-up capital shifts to restore the situation that would have prevailed if the shareholders had acquired separate classes.

10 30 & 31 Vict., c. 3, as amended.

that provision), which is to be tested through peaceful resistance in the form of “legitimate” tax avoidance<sup>11</sup> and dispassionate judicial review, as opposed to being tested in the manner that gave rise to Magna Carta (the dynamics of which more resembled those of a real—although reverse—cat and mouse situation).

Fifth, GAAR is a rule in the Act and, as such, it too is subject to, and also informs, the “unified textual, contextual and purposive” approach to the interpretation of the laws as described in *Canada Trustco*. Thus, there is specific legislative authority in Canada for the courts to apply a purposive approach in interpreting and applying other provisions of the Act as well as GAAR, although this is not to suggest that specific legislative authority was necessary in this regard. It is also important to acknowledge the significance of the textual element of this trinity, which reflects the recognition that, in order to maintain the rule of law, the words must matter, in that they embody the law as something that is distinct from its legislative purpose (or the purpose of the author(s) of the law), however much its interpretation may be informed by that purpose. Accordingly, it seems important, for example, to note that the language of GAAR has been amended in certain respects, and that this may have various implications. In particular, the language of the definition of a “tax benefit” in subsection 245(1), and of the “misuse or abuse test” in subsection 245(4), has been amended to include a reference to a tax treaty. More importantly, however, the meaning of “tax benefit” remains anchored in the notion of a reduction, avoidance, or deferral of tax or other amount payable (or an increase in a refund of tax or other amount) “under this Act.” On this basis, it is submitted that, whatever may be the significance of foreign tax considerations (or, for that matter, provincial tax considerations) in the context of applying GAAR (as discussed below in greater detail), the lawful reduction of any amount otherwise payable under foreign law (or under provincial law) simply cannot constitute a tax benefit for the purposes of the Act.

Finally, it is important to proceed through this examination of perspectives from the premise that reasonable people can reasonably disagree, whether as to general questions or specific ones, or as to fundamental questions or trivial ones. This is obvious from a review of the litigation leading to the decision of the Supreme Court of Canada in *Lipson*,<sup>12</sup> a case in which Bowman J had a hand.<sup>13</sup> Indeed, the judicial pronouncements of Bowman J seem to demonstrate that reasonable people can disagree not only with each other but even at times with themselves (given his comments in *Evans*<sup>14</sup> about his comments in *RMM Canadian*,<sup>15</sup> as discussed below). A

---

11 Indeed, it seems quite appropriate that the instrument by which the taxpayer disputes an assessment is called an “objection.”

12 *Lipson et al. v. The Queen*, 2009 DTC 5529 (SCC).

13 *Lipson et al. v. The Queen*, 2006 DTC 2687 (TCC).

14 *Evans v. The Queen*, 2005 DTC 1762 (TCC).

15 *Equilease Corporation v. The Queen*, sub nom. *RMM Canadian Enterprises Inc. et al. v. The Queen*, 97 DTC 302 (TCC).

number of observations seem to flow from this. Mainly, though, they converge around the notion that the benefit of a significant enough level of doubt should go to the taxpayer, and the notion that the abuse must meet a relatively high standard of clarity and demonstrability, again as acknowledged in *Canada Trustco* and elsewhere. From a systemic perspective, this appears to be a sensible compromise, in that it should tend to put the systemic cost of the inherent uncertainty (associated with having a system that operates as a function of judicial determinations, including with reference to abuse considerations) onto the general pool of taxpayers rather than the particular taxpayer. In other words, if we have to have a system that operates on the premise that there will be some mistakes (as we must, given the nature of the beast), when we err on the side of the Crown the cost of the mistakes will be foisted onto the particular taxpayer, a result that seems unfair. It seems more appropriate for the costs of inherent systemic uncertainty to be shared, and thus for us to err on the side of the particular taxpayer.

## JUDICIAL PRONOUNCEMENTS OF JUSTICE BOWMAN

There are three discrete issues on which Bowman J has made relevant pronouncements, although they do not all constitute pronouncements of ratio. Nevertheless, they likely constitute judicial dicta, rather than obiter dicta, if I have my jurisprudential technicalities in order.

The first issue is whether or not the presence of foreign non-taxation is significant as a consideration from a Canadian perspective, with respect to more general interpretive questions that arise in the treaty context—in brief, the issue of whether non-taxation or double non-taxation necessarily constitutes inherent abuse. The second issue involves determining the significance of foreign tax considerations in the specific context of applying GAAR. The third issue is whether or not the provisions of a tax treaty could preclude the application of GAAR.

### Double Non-Taxation and Inherent Abuse

The pronouncements of Bowman J with regard to the application of GAAR are perhaps more well known than those with regard to the “inherent abuse” issue, but it seems appropriate to begin with the latter. In this respect, reference may be made to his decision in *RMM Canadian*, and his informal decision in *Hausmann Estate v. R.*<sup>16</sup>

Essentially, the facts in *RMM Canadian* are as follows. A non-resident shareholder (“Equilease”) of an effectively inoperative Canadian-resident corporation (“Canco”) with undistributed surplus arranged to realize the value of its holdings through a sale to an unrelated Canadian-resident corporation (“RMM”) rather than a formal distribution from Canco, with a view to obtaining the benefit of an exemption from

---

16 [1998] 4 CTC 2232 (TCC).

Canadian taxation by virtue of article XIII (the capital gains article) of the Canada-US income tax convention, 1980.<sup>17</sup> The Tax Court held that the transactions fell within the ambit of subsection 84(2)—and that, in any event, the parties were not in fact dealing at arm's length, such that the transactions also fell within the ambit of section 212.1—with the result that a deemed dividend arose, to which article XIII of the US treaty did not apply. Rather, the court held, the deemed dividend fell within article X (the dividends article) of the US treaty, which specifically contemplated (in article X(3)) “income subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is a resident.” While the precise meaning and scope of that wording is somewhat unclear,<sup>18</sup> the court held that it would encompass deemed dividends under subsection 84(2) or section 212.1 (whether arising directly or by virtue of the application of GAAR).

Therefore, it was not necessary for the court to address the application of GAAR or the issue of inherent abuse, but Bowman J nevertheless proceeded to make a number of comments in this regard. One problem, however, is that it is difficult to separate the various comments into discrete lines of reasoning, since they were all made in the context of the GAAR discussion—more specifically, with respect to the question of “whether the U.S. Convention restricts the operation of section 245.”<sup>19</sup>

The first item reflects Bowman J's reaction to the proposition, advanced by the taxpayer, that the US treaty precluded the application of GAAR to recharacterize as a dividend what would normally constitute a capital gain on a sale of shares:

It is true that in the normal course a sale of shares would give rise to a capital gain or loss and would be taxed as such whether the taxpayer was a resident of Canada or the United States. I use the term “in the normal course” advisedly. This is not an ordinary sale of shares of a company that had an ongoing business that the purchaser intended to continue, as well, incidentally as a surplus. The sale of such a company to an arm's length purchaser would not give rise to a deemed dividend under section 84 and it could not be successfully attacked under section 245. What we are dealing with here, however, is a tax avoidance scheme that has as its predominant, indeed sole, object the extraction of corporate surplus under the umbrella of a transaction that is ostensibly an alienation to which Article XIII applies. The word “alienation” in Article XIII connotes a genuine alienation, and not one that is made to an accommodation party as an integral part of a distribution of surplus. I think that to permit such a transaction to shelter under the Convention would be to sanction an abuse of the treaty. It is true

---

17 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007 (herein referred to as “the US treaty”).

18 See John F. Avery Jones et al., “The Definitions of Dividends and Interest in the OECD Model: Something Lost in Translation?” [2009] no. 4 *British Tax Review* 406-52.

19 *RMM Canadian*, supra note 15, at 313.

that section 245 speaks of a misuse or abuse of the Act, but I can see no reason why a treaty provision should not be subject to the same principles of interpretation as domestic statutes insofar as they require that the provisions be construed in accordance with their object and spirit and the telos at which they are aimed and not in a manner that permits the perpetration of an abuse of the treaty.<sup>20</sup>

These comments are interesting in a number of respects, including with regard to the relationship between interpretive approaches and abuse considerations.

It is interesting to note the comment that the word “alienation” in article XIII “connotes a genuine alienation, and not one that is made to an accommodation party as an integral part of a distribution of surplus.” The only authority for this proposition cited by the court is the decision of the Tax Review Board in *Drummond Coal Co. Ltd. v. MNR*.<sup>21</sup> But that was not a case involving the interpretation of the US treaty—or, for that matter, any tax treaty at all. It did not even involve the interpretation of the word “alienation.” Moreover, the facts involved what was described by the appellant as a “sale” of the shares of a company to an unrelated party in contemplation of a dividend to be paid by the company, but subject to a legal right to *repurchase the very same shares* ex-dividend. Although it seems that the documentation was designed to create a sale with a repurchase *option*, the board found that, “from scrupulous examination of these facts, it appears that the transfer of shares could, in no way whatsoever, be branded as a sale of shares between the immediate parties involved.”<sup>22</sup> Thus, *Drummond Coal* is a *characterization* case, not an *interpretation* case, and not a case decided in the context of a tax treaty, although the fact that it was not decided in a treaty context is not important to the basic characterization question. What is important is that this decision does not in any way support the proposition that the words used in tax treaties generally or in the US treaty in particular should be interpreted in a manner that precludes or modifies their application to legally effective transactions (either singularly or as part of a series of transactions) that are otherwise within the ambit of the relevant words but are motivated by tax-avoidance considerations.

Our courts have not gone that far, either in the purely domestic context or in the treaty context, unlike the courts in the United Kingdom, although the latter also seem to be retreating to some extent from the step transaction doctrine, which they have at times described as a “principle of construction” (presumably because of more fundamental sensitivities surrounding the separation of powers), although really it seems (to me at least) to be more of a principle of *characterization*.<sup>23</sup> This has left the

---

20 Ibid., at 314 (citations omitted), but see below.

21 72 DTC 1217 (TRB).

22 Ibid., at 1221.

23 Compare, for example, *W.T. Ramsay Ltd. v. IRC*, [1981] 1 All ER 865 (HL), and *IRC v. Scottish Provident*, [2005] STC 15 (HL), with *Barclays Mercantile v. Mawson*, [2005] STC 1 (HL).

UK law “in a state of total confusion.”<sup>24</sup> We have a somewhat more principled approach to these matters, relying on more traditional jurisprudence with respect to interpretation and characterization issues, and on statutory departures from that standard, whether under GAAR or otherwise, as discussed in *Stubart Investments*.

Moving on, there is the comment in *RMM Canadian* that “to permit such a transaction to shelter under the Convention would be to sanction an abuse of the treaty.” In this regard, it seems important to note that the court’s observations do not appear to have been driven by any element of foreign non-taxation. If there was an “abuse” of the US treaty in the context of this case, it would have been on the basis that it was abusive to arrange one’s affairs to get the benefit of article XIII rather than the benefit of article X, since either way there was a treaty benefit, and the court did not suggest that no treaty benefit at all should be applicable. Moreover, although foreign tax considerations were raised as a factor in the context of the GAAR discussion, the court did not hold that the presence of foreign tax savings (that is, foreign non-taxation) was a reason to conclude that it would be abusive for the taxpayer to get the benefit of article XIII. Nevertheless, Bowman J did also make the following comments, which are somewhat more expansive:

I have not devoted much time to the principles to be followed in interpreting tax treaties. They have been the subject of a great deal of learned comment and little purpose would be served by yet another review of them. That they should be construed liberally and in a manner that will best achieve their purpose is obvious. In determining the intentions of the parties to a convention recourse may be had to a vast array of extrinsic materials, including the OECD Model Convention and the commentary on it as well as the *travaux préparatoires*. The matter was fully reviewed by the Supreme Court of Canada in *The Queen v. Crown Forest Industries Limited et al.*, 95 DTC 5389, particularly at 5396 to 5399. In that case the court quoted from the U.S. Senate (Foreign Relations Committee), *Tax Convention and Proposed Protocols with Canada*, as follows:

The principal purposes of the proposed income tax treaty between the U.S. and Canada are to reduce or eliminate double taxation of income earned by citizens and residents of either country from sources within the other country, and to prevent avoidance or evasion of income taxes of the two countries.

The Commentary to Article [1] of the OECD Model Convention states:

7. The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons; they should not, however, help tax avoidance or evasion.

---

24 According to Judith Freedman, as reported in Brian Arnold, Judith Freedman, Al Meghji, Mark Meredith, and Hon. Marshall Rothstein, “The Future of GAAR,” in *Report of Proceedings of the Fifty-Seventh Tax Conference*, 2005 Conference Report (Toronto: Canadian Tax Foundation, 2006), 4:1-16, at 4:13 (“The Future of GAAR”). See also Judith Freedman, “Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax Avoidance” (2005) vol. 53, no. 4 *Canadian Tax Journal* 1038-46; and Leonard Hoffmann, “Tax Avoidance” [2005] no. 2 *British Tax Review* 197-206.

Finally, I refer to paragraph 7, of Article XXIXA of the U.S. Convention which was added by the 1995 Protocol, effective January 1, 1996:

7. It is understood that the fact that the preceding provisions or 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 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.

The U.S. Technical Explanation to this paragraph reads:

Paragraph 7 was added at Canada's request to confirm that the specific provisions of Article XXIXA and the fact that these provisions apply only for the purposes of the application of the Convention by the United States should not be construed so as to limit the right of each Contracting State to invoke applicable anti-abuse rules. Thus, for example, Canada remains free to apply such rules to counter abusive arrangements involving "treaty-shopping" through the United States, and the United States remains free to apply its substance-over-form and anticonduit rules, for example, in relation to Canadian residents. This principle is recognized by the Organization for Economic Co-operation and Development in the Commentaries to its Model Tax Convention on Income and on Capital, and the United States and Canada agree that it is inherent in the Convention. The agreement to state this principle explicitly in the Protocol is not intended to suggest that the principle is not also inherent in other tax conventions, including the current Convention with Canada.

This explanation is accepted by the Canadian Minister of Finance. (News release 95-48, June 13, 1995.)

I recognize that the Protocol and Technical Explanation were added in 1995, years after the payments in question. Nonetheless they represent the agreed interpretation of Canada and the U.S. that the right of the parties to apply their own anti-abuse provisions is inherent in the Convention.<sup>25</sup>

Bowman J was quite correct in observing that the principles to be followed in interpreting tax treaties have been the subject of a great deal of learned comment. He may even have been correct in stating that the US treaty should not be interpreted in a manner that prevents the parties from applying any of their own anti-abuse provisions, and possibly even in his comments on the relevance in this regard of subsequent developments and commentaries, although questions in both connections could be raised on the basis of the reasons in *Garron Family Trust et al. v. The Queen*,<sup>26</sup> among others (see below). However, it appears that it would not be correct to suggest that Bowman J concluded that the presence of double taxation is an inherent

---

25 *RMM Canadian*, supra note 15, at 315-16 (notes omitted).

26 2009 DTC 1568 (TCC).

premise or condition of treaty benefits, or that double non-taxation is inherently abusive. On the contrary, as will become evident from a review of his comments in respect of the technical avoidance transaction issue under GAAR, and from his decision in *Hausmann*, it appears that Bowman J did not find foreign tax considerations to be significant—let alone determinative—from a Canadian perspective. Indeed, it does not even seem to be correct to suggest that his view was that tax treaties reflect an inherent anti-abuse principle that could have applied independently of GAAR (or of subsection 84(2) or section 212.1) to defeat the article XIII benefit, as distinguished from and going beyond a narrower principle that the parties to a treaty retain “the right . . . to apply *their own anti-abuse provisions* [emphasis added],” which seemingly refers to provisions extant *outside the four corners of the treaty*. He was presumably deliberate in framing his conclusion in terms of the application of GAAR leading to the application of subsection 84(2) or section 212.1, rather than in terms of the treaty benefit simply being denied because of inherent abuse, and he had already concluded at the outset of his GAAR discussion that “recourse to section 245 is not only unnecessary but inappropriate” where the relevant transactions “do not work in any event”<sup>27</sup>—as would have been the case if the treaty benefits had simply been denied because of inherent abuse.

The facts in *Hausmann* are not as “bad,” although they are somewhat curious. Hausmann was a Canadian resident receiving payments under a Belgian pension plan similar to the Canada Pension Plan. It seems that there were many others in the same boat, and that there were two classes of passengers—those who had had amounts of tax withheld at source in Belgium, and those who had suffered no such withholding. Apparently, on the basis of information slips and a letter received from the Belgian Ministry of Finance, Canadian revenue authorities had set about assessing Canadian taxes against all Canadian-resident Belgian pensioners who had not suffered withholding. Hausmann was among the latter, and was assessed for several taxation years. In objecting to these assessments, he asserted the benefit of article XVIII(2) of the Canada-Belgium Income Tax Convention, which provided that “social security pensions . . . paid by a Contracting State . . . shall be taxable only in that State.”<sup>28</sup> Thus, he argued, Canada could not tax the payments, whether or not they were taxed in Belgium. Interestingly, the letter from the Belgian Ministry of Finance took a different view of the matter, expressing the following analysis:

27 *RMM Canadian*, supra note 15, at 311: “If I am right in believing that sections 84 and 212 or, alternatively, section 212.1, by themselves result in taxing this surplus strip, recourse to section 245 is not only unnecessary but inappropriate. The application of section 245 depends upon the existence of an ‘avoidance transaction’ which is a transaction that, but for this section, would result in a tax benefit. In other words, for section 245 to apply, the transaction has to otherwise ‘work’ in the sense of achieving its intended fiscal result. Therefore section 245 is aimed at successful tax avoidance schemes. If they *do not work in any event* section 245 is unnecessary. As stated above in my discussion of section 84, I do not think the transaction works, quite apart from section 245. If I am wrong in that conclusion, I must consider section 245.”

28 Canada-Belgium Income Tax Convention Act, 1976, SC 1974-75-76, c. 104, schedule II.

For its part, Canada must avoid double taxation of these Belgian-source pensions by applying the tax owed in Belgium to the Canadian tax. That way, when a pension has not been actually taxed in Belgium, Canada can tax the pension without restriction.<sup>29</sup>

Bowman J did not take kindly to this letter, describing it as a “somewhat presumptuous letter, in which some official in the Belgian government purports to instruct the Government of Canada on how it should administer its tax laws.”<sup>30</sup> Moreover, he made the following, rather colourful, comments concerning the Crown’s theory of the case, which appears to have been erected entirely upon the ground of preventing double non-taxation:

The theory appears to be that if Belgium is not going to tax the pension Canada should. Otherwise the unthinkable might occur and the amount might not be taxed by anyone. This would be anathema. This view seems to be consistent with the view expressed in the Belgian letter.<sup>31</sup>

On a more serious note, Bowman J then clearly articulated his analysis in this regard, to the effect that the presence of double taxation was not a premise or condition of the treaty benefit, and that the presence of double non-taxation did not preclude or modify the treaty benefit:

The evidence appears to establish that the payments received by Mr. Hausmann fell below a certain threshold, and were therefore not taxed by Belgium. It is, however, not clear whether the threshold is the same for residents of Belgium or non-residents. One thing, however, is quite clear and it is that the premise upon which the assessment was based, that if Belgium did not tax the payments they must be taxable by Canada, is plainly wrong as is the opinion expressed by the Belgian official in Exhibit R-6.<sup>32</sup>

Then, after analyzing the nature of the payments here in question, he continued:

The inference that I draw from this is that Canada regards is [sic] CPP payments as social security benefits. Therefore, in negotiating the Belgian treaty, both Canada and Belgium unquestionably regarded pensions paid under their social security legislation, such as the CPP or the corresponding Belgian statutory scheme, to be taxable only in the country from which they emanated and not the country of residence of the recipient.<sup>33</sup>

And finally, on the basis of this determination as to the intention of the contracting states as expressed in the treaty, Bowman J concluded that the payments could not

---

29 *Hausmann*, supra note 16, at paragraph 13.

30 *Ibid.*, at paragraph 14.

31 *Ibid.*, at paragraph 15.

32 *Ibid.*, at paragraph 20.

33 *Ibid.*, at paragraph 27.

be taxed by Canada—and that, in this regard, “[t]he fact that Belgium chose not to tax them in this case is *irrelevant*.”<sup>34</sup> This is an interesting choice of words, because “irrelevant” is an absolute term: the foreign tax treatment in this case, which clearly consisted of non-taxation, was held to be completely and absolutely not significant as a consideration with respect to the availability of the treaty benefit, which in this case necessarily gave rise to double non-taxation. It is interesting also that, in determining this intention of the contracting states, *Bowman J* rejected the positions then being expressed by the tax authorities of Canada and of Belgium. In other words, the intention of the contracting states was determined primarily on the basis of their understandings and expectations at the time that the treaty was concluded, and as expressed in the words of the treaty, and was not seen as something that could depend on what might have been a subsequent change of heart on the part of the tax authorities or some more general and pervasive concern about the “unthinkable anathema” of double non-taxation.

To be fair, it seems unlikely that *Bowman J* was making light of what could be regarded as abusive tax avoidance, but in any event, *Hausmann* was no such case. If there was double non-taxation in this case, it was not inherently abusive or anathema. Rather, it was the result that flowed naturally from the law—meaning the provisions of the treaty, interpreted without any overriding gloss that would limit their scope to situations involving the presence of double taxation, on the basis of some overly purposive approach to the interpretation exercise or otherwise. This is not to say that *Bowman J* applied an overly textual approach. On the contrary, he seems to have struck the right balance between the various elements of a “unified textual, contextual, and purposive” approach to the interpretation exercise (although not under that moniker as such), in which the words still matter, and in which there is no dogmatic aversion to double non-taxation.

It is submitted that *Bowman J*’s analysis in *RMM Canadian* and *Hausmann* is consistent with the jurisprudence both before and after these decisions. In this regard, it should be recalled that the significance of double non-taxation as a factor was actually considered in the oft-quoted decision in *Gladden Estate v. The Queen*,<sup>35</sup> which took the lead in our jurisprudence on the matter of applying a more liberal and purposive approach to the interpretation of our treaties. The following comments of *Addy J* should be noted:

The plaintiff argues that the intention of the parties was obviously to exempt non-residents of each country from capital gains tax which that country might impose. Canada, in fact, did not have a capital gains tax at the time but the wording of Article VIII [of the US treaty] is quite clear. I therefore fail to understand the finding of the Tax Court below to the effect that because Canada had no capital gains tax it was not and is not bound by Article VIII. After quoting the article textually, the learned Judge summarily

34 *Ibid.*, at paragraph 29 (emphasis added).

35 85 DTC 5188 (FCTD).

rejected the argument with which I am dealing in the following terms: “the parties could not have negotiated to avoid double taxation on a tax which did not exist in Canada.” It seems to be trite law that a person can contract in anticipation of the possible occurrence of a future event.<sup>36</sup>

And further, Addy J held as follows:

The estate was taxed in the United States on the shares on the basis of an estate tax liability and certain arguments were addressed to the question of whether taxation on the value of an asset pursuant to an estate tax or succession duty statute in one country can be considered double taxation when the incidence of the tax on the same asset arising out of the same event is based on a capital gain in the other country. *There is no need, in my view, to determine this issue at all* since, on a simple reading of Article VIII, *it seems evident that double taxation is neither a condition nor a prerequisite for invoking the protection of the treaty*. The non-resident can benefit from the exemption regardless of whether or not he is taxable on that capital gain in his own country. If Canada or the U.S. were to abolish capital gains completely, while the other country did not, a resident of the country which had abolished capital gains would still be exempt from capital gains in the other country. This in effect was the situation between the time the treaty took effect and Canada in fact first imposed a capital gains tax. During that period Canadians could benefit from Article VIII.<sup>37</sup>

On this basis, it seems quite correct to conclude that even a purposive or “liberal” approach to the interpretation exercise does not support the view that the presence of double taxation is an inherent premise or condition of treaty benefits, or that double non-taxation is inherently abusive or anathema.

This proposition has also been rejected, and no less categorically, in more recent cases. For example, in *The Queen v. MIL (Investments) S.A.*, the Federal Court of Appeal concluded that

[t]o the extent that the appellant argues that the Tax Treaty should not be interpreted so as to permit double non-taxation, the issue raised by GAAR is the incidence of Canadian taxation, not the foregoing of revenues by the Luxembourg fiscal authorities.<sup>38</sup>

While this statement does not draw the clearest boundaries between the interpretive issues and the GAAR issues, the court’s perspective is unquestionable. This was a “treaty-shopping” case, in a sense, in which a Cayman Islands corporation, which held shares of a Canadian corporation that constituted “taxable Canadian property,” was continued to Luxembourg before disposing of the shares and then claimed the

---

36 *Ibid.*, at 5189.

37 *Ibid.*, at 5192 (emphasis added).

38 2007 DTC 5437, at paragraph 8 (FCA).

benefit of an exemption from Canadian taxation under article 13 of the Canada-Luxembourg income tax convention.<sup>39</sup>

At trial, the Crown had taken the position “that ‘treaty shopping’ is an abuse of bilateral tax conventions and that this is recognized by the Supreme Court of Canada.”<sup>40</sup> The Tax Court’s reaction to that position was the following:

In oral argument, the following passage from *Crown Forest* . . . was quoted to establish that if the Supreme Court had [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.<sup>41</sup>

Undoubtedly, these comments were inspired to some extent by the reasoning of Bowman J in *RMM Canadian*. Not only was that decision referred to in *MIL* in the context of providing an example of “potential abuse” (interestingly though, not *necessarily* abuse), but also the reasoning of the two judgments is couched in similar terms—that is, as an inquiry into whether or not it was “abusive” to claim the particular treaty benefit (an article XIII exemption) rather than any treaty benefit at all.<sup>42</sup>

Moreover, the Tax Court had categorically rejected the Crown’s assertion that the Luxembourg treaty contemplated an “inherent anti-abuse rule”:

Overall, I found Steichen’s opinion and testimony not substantively convincing. [Steichen was an expert witness testifying for the Crown.] 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.

39 Convention Between the Government of Canada and the Government of the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Luxembourg on September 10, 1999 (herein referred to as “the Luxembourg treaty”).

40 *MIL (Investments) S.A. v. The Queen*, 2006 DTC 3307, at paragraph 72 (TCC).

41 *Ibid.* (notes omitted, emphasis added).

42 Also see *ibid.*, at paragraph 70.

Simply put, the “ordinary meaning” of the Treaty allowing the Appellant to claim the exemption must be respected.<sup>43</sup>

At the Federal Court of Appeal, these conclusions were then reinforced with a variety of comments, including those reproduced above and the following:

[W]e are unable to see in the specific provisions of the *Income Tax Act* . . . and the Tax Treaty to which we were referred, interpreted purposively and contextually, any support for the argument that the tax benefit obtained by the respondent was an abuse or misuse of the object and purpose of any of those dispositions.

It is clear that the Act intends to exempt non-residents from taxation on the gains from the disposition of treaty exempt property. It is also clear that under the terms of the Tax Treaty, the respondent's stake in DFR was treaty exempt property. The appellant urged us to look behind this textual compliance with the relevant provisions to find an object or purpose whose abuse would justify our departure from the plain words of the disposition. *We are unable to find such an object or purpose.*

If the object of the exempting provision was to be limited to portfolio investments, or to non-controlling interests in immovable property (as defined in the Tax Treaty), as the appellant argues, it would have been easy enough to say so. Beyond that, and more importantly, *the appellant was unable to explain how the fact that the respondent or Mr. Boule had or retained influence of control over DFR, if indeed they did, was in itself a reason to subject the gain from the sale of the shares to Canadian taxation rather than taxation in Luxembourg.*<sup>44</sup>

These comments are interesting in a number of respects, but primarily in light of the observation that double non-taxation was clearly present in the circumstances, and that the taxpayer entity was owned and controlled by a third-country resident. In brief, the Court of Appeal was “unable to find” inherent in the Luxembourg treaty any “object or purpose” of preventing double non-taxation or treaty shopping.

There is also the decision of the Federal Court of Appeal in *The Queen v. Prévost Car Inc.*<sup>45</sup> In this case, a Dutch corporation was interposed between a Canadian corporation and its foreign corporate shareholders, being residents of the United Kingdom and of Sweden, in order to obtain the benefit of a lower rate of Canadian withholding taxes on dividends from the Canadian corporation. Interestingly, the Crown did not assert the application of GAAR but seems to have been content to test the limits of the notion of “beneficial ownership.” That line of argument similarly met with a categorical rejection:

The Crown, it seems to me, is asking the Court 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>46</sup>

43 Ibid., at paragraph 87.

44 *MIL*, supra note 38, at paragraphs 5-7 (emphasis added).

45 2009 DTC 5721 (FCA).

46 Ibid., at paragraph 15.

These comments are particularly important because the Federal Court of Appeal had accepted that, in the course of the interpretation exercise, it would be proper to at least consider “the OECD Conduit Companies Report (in 1986) as well as the OECD 2003 Amendments to the 1977 Commentary,” but only as a “helpful complement to the earlier Commentaries” and only “insofar as they are eliciting, rather than contradicting, views previously expressed.”<sup>47</sup>

It seems difficult to disagree with this passage from *Prévost Car*. As noted earlier, Bowman J was indeed correct that the principles to be followed in interpreting tax treaties have been the subject of a great deal of learned comment, and they have also been the subject of reconsideration by the OECD for decades; but is it fair to say—let alone is it demonstrable to the satisfaction of a legal standard—that there is any real consensus in the international community, or even within the Canadian government, as to the proper view of the use of holding companies (for treaty shopping or otherwise) and of the other usual elements of international tax planning, including various financing structures, as well as hybrid instruments and entities? That is a serious question, and it demands a serious answer because, it is submitted, without such an answer it would be improper for the courts of Canada to embark upon what could be seen as an adventure toward a revolution in the international fiscal order. If there were really any strong consensus along these lines in the international community, one would have expected the OECD’s harmful tax competition initiative<sup>48</sup> to have yielded more than just greater information sharing. Moreover, it seems clear that many advanced countries are increasingly moving in the direction of reinforcing or reorienting their international tax systems more toward the territorial taxation of business income. This trend is evident in Australia, the United Kingdom, Japan, Germany, and Italy, to name a few—although the wild card seems to be the United States. Withholding taxes are also generally coming down, particularly in the non-portfolio context.

As for the government of Canada, we have seen conflicting tendencies, with the introduction of various measures that were subsequently withdrawn, including an “anti-double-dip” rule under section 18.2; sweeping foreign affiliate, foreign investment entity, and non-resident trust rules; and measures relating to fiscally transparent entities recently introduced into the US treaty. In the face of their patent incoherence, both technically and from a policy perspective, these measures were quickly dismantled by their authors and the Canadian tax administration through a series of public statements and rulings that helped to keep the system functional.<sup>49</sup>

---

47 Ibid., at paragraph 12.

48 Organisation for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998).

49 As discussed in greater detail in Marc Darmo and Angelo Nikolakakis, “The New Rules on Limitation on Benefits and Fiscally Transparent Entities,” in *Report of Proceedings of the Sixty-First Tax Conference*, 2009 Conference Report (Toronto: Canadian Tax Foundation, 2010), 26:1-80.

The government also appointed an advisory panel on Canada's system of international taxation, with a view to revisiting both the premises and the details of that system. The advisory panel delivered its report in December 2008,<sup>50</sup> and in that report there is no evidence of any international consensus against treaty shopping and double non-taxation. On the contrary, one of the principles reflected in the report is "benchmarking," and on that basis in part (and perhaps in large part at that), it was recommended that Canada should maintain and expand its exemption system and not introduce any new general restrictions on interest deductibility or measures aimed at treaty shopping.<sup>51</sup> Whether the recommendation is sound or not does not matter for present purposes, because it is the underpinning of the recommendation that is important. The general tendency of relevant foreign countries is to permit fiscal arrangements of this nature, and even at times to encourage them in the out-bound direction, and it remains their sovereign right to do so.

How, then, can one disagree with the decision of the Federal Court of Appeal in *Prévost Car*? It is true that there has been increasing coordination and cooperation among countries, including Canada, in the context of international taxation in general and international tax planning in particular—but, to date, these efforts have produced little more than greater information sharing and, to some extent, greater assistance in collection. No strong consensus has emerged on the appropriate policy responses, if any, to treaty shopping and double non-taxation, despite the 1992 and 2003 revisions to the commentary on the OECD's model tax convention,<sup>52</sup> incorporating elements of three earlier OECD reports on, respectively, the use of base companies,<sup>53</sup> the use of conduit companies,<sup>54</sup> and the application of the OECD model to partnerships.<sup>55</sup> It seems obvious that it is these revisions to the commentary, and similar ones, that have prompted comments like that of the Federal Court of Appeal in *Prévost Car*, noted above, to the effect that subsequent commentaries should be given weight in the interpretive process only "insofar as they are eliciting, rather than contradicting, views previously expressed." These are somewhat diplomatic words but, coming from the Federal Court of Appeal, they are words of great significance. While this approach seems to be taken for granted by the OECD, which says that

---

50 Advisory Panel on Canada's System of International Taxation, *Final Report: Enhancing Canada's International Tax Advantage* (Ottawa: Department of Finance, December 2008).

51 See *ibid.*, chapter 4 and the discussion of treaty shopping in chapter 5.

52 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf) (herein referred to as "the OECD model").

53 OECD Committee on Fiscal Affairs, "Double Taxation Conventions and the Use of Base Companies," adopted by the OECD Council on November 27, 1986. See the OECD model, *supra* note 52, vol. 2, at R(5)-1 to R(5)-34.

54 OECD Committee on Fiscal Affairs, "Double Taxation Conventions and the Use of Conduit Companies," adopted by the OECD Council on November 27, 1986. See the OECD model, *supra* note 52, vol. 2, at R(6)-1 to R(6)-25.

55 OECD Committee on Fiscal Affairs, "The Application of the OECD Model Tax Convention to Partnerships," adopted by the OECD Committee on Fiscal Affairs on January 20, 1999. See the OECD model, *supra* note 52, vol. 2, at R(15)-1 to R(15)-98.

subsequent commentaries “are normally applicable to the interpretation and application of conventions concluded before their adoption, *because* they reflect the consensus of the OECD Member countries as to the proper interpretation of existing provisions and their application to specific situations,”<sup>56</sup> it should not be taken for granted by a court of law.

Indeed, what the Federal Court of Appeal seems to be acknowledging is that there are particular paragraphs of the commentary that reflect what could be described as a high degree of fidelity to the provisions of the OECD model and earlier commentaries, and particular paragraphs of the commentary that reflect a lower degree of such fidelity. In the context of such low-fidelity paragraphs, it is only proper for a court to be reluctant to draw inferences, on this basis, about the intentions of the parties to pre-existing treaties. However, it is submitted that this type of inquiry, into the fidelity of a particular item in the commentary, is equally appropriate in the context of treaties entered into *after* the relevant revisions. It has become almost a mantra to suggest that a particular country should be taken to agree to the commentary and its revisions unless it has registered an observation,<sup>57</sup> but is that really true? Drawing such a conclusion, on that basis alone, would be worse than relying on hearsay—it would amount to relying on “did not hear say”! There may be many reasons why a particular country may not have expressed observations on a particular item of the commentary, some diplomatic and some perhaps practical (for example, the delegation simply did not act to do so). But here too, in each case, there is an answer to the question, and it should not be taken for granted by a court of law. The commentary is not binding on anyone, and this does not seem to be a proper context for estoppel. While the burden of proof may normally be on the taxpayer, the courts (including the Supreme Court of Canada in *Canada Trustco*) have acknowledged that the burden of persuasion on the question of abuse lies with the Crown.

And there is yet another, more important reason to be skeptical about the inferences that one might draw from a country’s lack of observations on the revisions to the commentary. It is interesting to note the paragraph that often gets referred to in this context. In its current version, the following appears under the heading “Improper Use of Tax Treaties”:

The *principal purpose* of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a *purpose* of tax conventions to prevent tax avoidance and evasion.<sup>58</sup>

56 Paragraph 35 of the introduction to the OECD model, *supra* note 52 (emphasis added).

57 See, for example, *RMM Canadian*, *supra* note 15, at 314-15: “Neither Canada nor the United States reserved on Article 10 of the Model Convention or on this portion of the commentary. Therefore it may be assumed that this interpretation is accepted by both parties. In my opinion the definition of dividends in the U.S. Convention is broad enough to cover the payments received by EC to the extent that they exceeded EL’s paid-up capital.”

58 Paragraph 7 of the commentary on article 1, the OECD model, *supra* note 52 (emphasis added).

As noted above, an earlier version of this paragraph was referred to by Bowman J in *RMM Canadian*:

7. *The purpose* of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons; they should not, however, *help* tax avoidance or evasion.<sup>59</sup>

This is a truncated quotation, which omits the following:

True, taxpayers have the possibility, double taxation conventions being left aside, to exploit differences in tax levels between States and the tax advantages provided by various countries' taxation laws, *but it is for the States concerned to adopt provisions in their domestic laws to counter such manoeuvres. 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.*<sup>60</sup>

In *MIL*, it is the full text of the pre-2003 version of this paragraph that was considered by the court, and as to which the Crown had led expert evidence on tax treaty interpretation. The reasons of the Tax Court reflect the following exchange between the Crown's expert and the taxpayer's counsel:

When asked by Appellant's counsel whether that paragraph meant "if you want an anti-avoidance rule in the treaty, you should put it in the treaty?" Steichen responded:

I would agree with that, yes.

The exchange continued:

Q. At the time this treaty was put together, the contemporaneous material specifically said, "If you want to put an anti-abuse provision in a treaty, you must specifically do so." Would you agree with that?

A. That's right.<sup>61</sup>

Obviously, paragraph 7 of the commentary on article 1 was revised in 2003 to drop the references to it being "for the States concerned to adopt provisions in their domestic laws to counter such manoeuvres." Moreover, a series of additional paragraphs was introduced into the commentary at the same time, detailing arguments as to possible interpretations that one might adopt in order to defeat tax avoidance in the treaty context, as well as a large variety of specific anti-avoidance provisions

59 *RMM Canadian*, supra note 15, at 316 (emphasis added).

60 Paragraph 7 of the commentary on article 1, Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD, 1977) (herein referred to as "the 1977 OECD model") (emphasis added), as quoted in *MIL*, supra note 40, at paragraph 84.

61 *MIL*, supra note 40, at paragraph 84.

that could be introduced into bilateral tax treaties in order to address these types of concerns. But it seems very difficult to reasonably consider that these revisions reflect any sort of real international consensus on these matters.

On the contrary, the 2003 revisions, like the 1992 revisions, reflect the continued existence of considerable disagreement among members of the international community (including non-members of the OECD, whose positions are now also recorded) with regard to these matters, although the OECD's acknowledgment of this is more obscure under the current version of the commentary. After the 1992 revisions, the commentary on article 1 included the following version of paragraph 12, which appears after the mention (in paragraph 11) of the reports on base companies and conduit companies:

Several solutions have been considered 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 applied made, and no exhaustive list of such possible counter-measures given. The texts quoted below are merely intended as suggested benchmarks that treaty negotiators might consider when searching for a solution to specific cases.<sup>62</sup>

This paragraph must be read together with the paragraphs that follow it, including these:

24. It is not easy to reconcile these *divergent opinions, either in theory or in mutual agreement procedures on specific cases*. The main problem seems to be whether or not general principles such as “substance-over-form” are inherent in treaty provisions, i.e. whether they can be applied in any case, or only to the extent they are expressly mentioned in bilateral conventions. The dissenting view argues that to give domestic rules precedence over treaty rules as to who, for tax purposes, is regarded as the recipient of the income shifted to a base company, would erode the protection of taxpayers against double taxation (e.g. where by applying these rules, base company income is taxed in the country of the shareholders even though there is no permanent establishment of the base company there). However, it is the view of the wide majority that such rules, and the underlying principles, do not have to be confirmed in the text of the convention to be applicable.

25. While these and the other counteracting measures described in the reports mentioned in paragraph 11 above are not inconsistent with the spirit of tax treaties, there is agreement that Member countries should carefully observe the specific obligations enshrined in tax treaties, as long as there is no clear evidence that the treaties are being improperly used. Furthermore, it seems desirable that counteracting measures comply with the spirit of tax treaties with a view to avoiding double taxation. Where

---

62 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD, 1995) (looseleaf) (herein referred to as “the 1995 OECD model”), commentary on article 1, paragraph 12, added by Council of the OECD, “The Revision of the Model Convention,” July 23, 1992, effective September 22, 1995 to January 27, 2003.

the taxpayer complies with such counteracting measures, it might furthermore be appropriate to grant him the protection of the treaty network.<sup>63</sup>

This is hardly evidence of a strong international consensus on these matters. Of course, in 2003, these paragraphs were eliminated from the commentary. However, these and other changes to the commentary continue to reflect substantial disagreement on these matters in the international community. Indeed, in paragraphs 9.1 through 9.3 of the current commentary on article 1, the continued existence of different approaches is acknowledged, and while paragraph 9.4 concludes that something “is agreed,” that “something” is not that the interpretation and application of tax treaties necessarily contemplates an inherent anti-abuse rule.

It is also interesting to consider the comments of Richard Tremblay in this regard, written in 1995 between the two major revisions.<sup>64</sup> Tremblay made a compelling argument, based on a penetrating analysis, that the 1992 revisions deliberately drew a distinction between treaty-shopping situations (referred to as “conduit company” situations) and cases that would normally come within controlled foreign corporation provisions like Canada’s foreign accrual property income (FAPI) rules (referred to as “base company” cases). In fact, he argued, these revisions deliberately stopped short of endorsing “solutions” to treaty-shopping situations through means other than specific bilateral treaty provisions, and perhaps should even be taken to have positively discouraged the use of such means (on the basis of the comments in paragraph 43 of the report on base companies, which specifically contemplated the granting of treaty benefits even in the face of what is regarded as an improper use).<sup>65</sup> While such a distinction in approach to the two categories of issues is no longer really reflected in the commentary, as a result of the 2003 revisions, the interesting aspect of Tremblay’s comments is how plain they make it that this evolution (or, perhaps, revolution) in the commentary has occurred without any corresponding change to the provisions of the OECD model.

A similar observation can be made with reference to the difference between the 1992 revisions and the 2003 revisions in relation to the treatment of partnerships. Even after those revisions, paragraph 6 of the commentary on article 1 stated quite unequivocally that “[t]he Convention does not . . . contain any special provisions relating to partnerships,”<sup>66</sup> and this despite the observation in the same paragraph that non-taxation can result in the context of the application of tax treaties in partnership situations. Thus, the paragraph concluded, contracting states should be “free to examine the problems of partnerships in their bilateral negotiations and to

63 Ibid., commentary on article 1, paragraphs 24-25.

64 Richard G. Tremblay, “GAAR and Treaty Shopping,” in *Report of Proceedings of the Forty-Seventh Tax Conference*, 1995 Conference Report (Toronto: Canadian Tax Foundation, 1996), 38:1-42.

65 Supra note 53.

66 1977 OECD model, supra note 60, commentary on article 1, paragraph 6, effective before July 23, 1992.

agree upon such special provisions as they may find necessary and appropriate.<sup>67</sup> In contrast, the 2003 revisions incorporated the OECD's 1999 report on partnerships,<sup>68</sup> articulating a full-blown theory (or perhaps several of them) as to how existing tax treaties should be interpreted and applied in the context of hybrid partnership situations. These revisions closely resembled section 894(c) of the US Internal Revenue Code<sup>69</sup> and related regulations (which were introduced in the period between the 1992 and 2003 revisions). The great irony, of course, is that the United States has now adopted very specific rules in this context, as contemplated by the 1992 revisions, while the OECD is now saying, under the 2003 revisions, that no such provisions are necessary. This, too, makes it apparent that the relationship between the words in the OECD model and the contents of the commentary is becoming somewhat more remote with each revision. This had already been observed by David Ward in 1999,<sup>70</sup> and the phenomenon has only increased since that time.

Apparently, the weakening relationship between the OECD model and the commentary has not been accidental, or serendipitous. In this regard, it is instructive to consider certain revisions that were made after 2003. In particular, it is interesting to note the revisions to paragraph 31 of the introduction to the OECD model and commentary, which deals with the subject of reservations. The current version is as follows:

Although all Member countries are in agreement with the aims and the main provisions of the Model Convention, nearly all have entered reservations on some provisions, which are recorded in the Commentaries on the Articles concerned. There has been no need for countries to make reservations indicating their intent to use the alternative or additional provisions that the Commentaries allow countries to include in their bilateral conventions *or to modify the wording of a provision of the Model to confirm or incorporate an interpretation of that provision put forward in the Commentary*. It is understood that insofar as a Member country has entered reservations, the other Member countries, in negotiating bilateral conventions with the former, will retain their freedom of action in accordance with the principle of reciprocity.<sup>71</sup>

This revision was made as part of the 2005 update of the OECD model, which added the emphasized text. What is particularly interesting about this text is that it refers not only to revisions to the OECD model *confirming* an interpretation put forward in the commentary, but also to revisions *incorporating* an interpretation put forward in the commentary. Setting aside questions of grammar and syntax, which in turn

---

67 Ibid.

68 Supra note 55.

69 Internal Revenue Code of 1986, as amended.

70 See David A. Ward, "Tax Treaties: An Eroding Set of Rules," in *Report of Proceedings of the Fifty-First Tax Conference*, 1999 Conference Report (Toronto: Canadian Tax Foundation, 2000), 41:1-21.

71 Paragraph 31 of the introduction to the OECD model, supra note 52 (emphasis added).

raise questions about the intended meaning of the text, the revision to paragraph 31 echoes the reference to an “ambulatory Model Convention” in paragraph 9 of the introduction.

Arguably, the theory of an ambulatory model convention should not be acceptable to a Canadian court. Canadian courts are unlikely to be any more enthusiastic about the prospect of allowing the interpretation and application of Canadian law to be determined by conceptions of “international fiscal meaning” developed by the OECD for the purpose of reinforcing its theory of an ambulatory model convention, than they have been about the prospect of necessarily determining income as a function of evolving generally accepted accounting principles. In the latter context, the Supreme Court of Canada commented in *Canderel Limited v. The Queen*:

The great difficulty which seems to have plagued the courts in the assessment of profit for income tax purposes bespeaks the need for as much clarity as possible in formulating a legal test therefor. The starting proposition, of course, must be that the determination of profit under s. 9(1) is a question of law, not of fact. Its legal determinants are two in number: first, any express provision of the *Income Tax Act* which dictates some specific treatment to be given to particular types of expenditures or receipts, including the general limitation expressed in s. 18(1)(a), and second, established rules of law resulting from judicial interpretation over the years of these various provisions.

Beyond these parameters, any further tools of analysis which may provide assistance in reaching a determination of profit are just that: interpretive aids, and no more. Into this category fall the “well-accepted principles of business (or accounting) practice” which were mentioned in *Symes*, also referred to as “ordinary commercial principles” or “well-accepted principles of commercial trading,” among other terms. A formal codification of these principles is to be found in the “generally accepted accounting principles” (“G.A.A.P.”) developed by the accounting profession for use in the preparation of financial statements. These principles are accepted by the accounting profession as yielding accurate financial information about the subject of the statements, and become “generally accepted” either by actually being followed in a number of cases, by finding support in pronouncements of professional bodies, by finding support in the writings of academics and others, or by more than one of these methods: see Peter W. Hogg and Joanne E. Magee, *Principles of Canadian Income Tax Law* (2nd ed. 1997), at pp. 180-81. *What must be remembered, however, is that these are non-legal tools and as such are external to the legal determination of profit, whereas the provisions of the Act and other established rules of law form its very foundation.*<sup>72</sup>

Arguably, the same could be said for the OECD model and its commentaries. That is, these are “non-legal tools,” and as such are “external to the legal determination” of the availability of treaty benefits, whereas the provisions of the Act and the relevant treaty, and “*other established rules of law*,” form its very foundation.

It is submitted that such an effective delegation as there would be if Canadian courts simply deferred to the accounting profession on profit determinations, or to

---

72 98 DTC 6100, at 6106 (SCC) (emphasis added).

the OECD on treaty-abuse determinations, would not be compatible with the rule of law as we understand it in Canada. Even the Income Tax Conventions Interpretation Act<sup>73</sup> (“the ITCIA”) does not go that far. While it mandates a certain ambulatory approach to the interpretation and application of our treaties, it does so only by reference to Canadian law, and does not in any way purport to adopt the OECD commentaries. It is also interesting to note that Canadian finance and revenue authorities have to date declined to interpret and apply our tax treaties in accordance with revisions incorporating the OECD’s report on partnerships, as demonstrated by a number of rulings that have been issued concerning so-called synthetic NROs,<sup>74</sup> and by the recent litigation in *TD Securities (USA) LLC v. The Queen*.<sup>75</sup> In *TD Securities*, the Crown is declining to extend the benefits of the US treaty to the Canadian branch profits of a US limited liability company (LLC) that is disregarded for US tax purposes but is held by a taxable US corporation—in other words, it is the Crown that is taking the position that the commentaries do not govern. While the views of Canadian finance and revenue authorities toward certain types of international tax planning may have evolved to some extent, and will undoubtedly continue to evolve, it is submitted that there has not been any revolution with respect to the laws of Canada (including our jurisprudence) that would render the commentaries determinative as to the interpretation or application of Canadian tax treaties entered into either before or after any particular revision, with the exception of the direction to apply them under paragraph 9 of the binding arbitration procedure contemplated by annex A to the US treaty. Again, subject to such exceptions, the commentaries are merely non-legal tools, and while they should be considered, they cannot form the foundation of a legal determination. The textual element of a “unified textual, contextual, and purposive” interpretation remains important to Canadian courts, and at some point the commentaries cease to constitute interpretive tools in contexts where they reflect too great a departure from the more usual interpretation of the relevant words and their historically intended meanings and effects.

Moreover, while some countries use the doctrines of substance over form and economic substance,<sup>76</sup> Canada is not really among them. In this regard, in addition to an abundance of statements in our jurisprudence—including the decision of the Supreme Court of Canada in *Canada Trustco*—there is the interesting perspective expressed by Rothstein J (just a few months before his elevation to the Supreme Court) in a panel discussion about that decision at the 2005 annual tax conference:

---

73 RSC 1985, c. I-4, as amended.

74 See the discussion in Tom Vowinckel, “Replacing NRO Structures with Reverse Hybrids,” in *Report of Proceedings of the Fifty-Third Tax Conference*, 2001 Conference Report (Toronto: Canadian Tax Foundation, 2002), 10:1-18.

75 2010 TCC 186. For a discussion of this decision, see Darro and Nikolakakis, *supra* footnote 49, as well as the commentary published with the report of the decision in [2010] 12 ITLR (5) 783.

76 Paragraph 22 of the commentary on article 1, the OECD model, *supra* note 52.

Mark Meredith: I think I should pass to judgment here on at least one aspect, if I might direct the discussion back to you, Justice Rothstein. There is one point that Brian [Arnold] made that I have wrestled with as well—and Brian, I think this may be part of what gives rise to your reaction of distaste with the result in *Canada Trustco*. While I think the decisions in the courts below so far have been right, I feel the resulting cost to the fisc in my pocket as well. That said, Brian made the observation that if the decision in *Canada Trustco* is right, why would any leasing company pay tax? Justice Rothstein, let me ask you this: Is that something that you would, and we should, care about in interpreting the Act and GAAR?

Hon. Marshall Rothstein: Well, I won't answer that question, but what I will say is this: I have no opinion about economic substance one way or the other. It's something that is going to have to be argued and, at that point, we'll have to decide whether we have enough to be able to embark upon it. What I do know, or what I am concerned about, is that when the argument comes forward we are going to have to be told how we are supposed to apply economic substance in the GAAR context. How will we know when we are supposed to be looking at transactions or whether we are supposed to be cutting through the transactions and looking at economic substance? How will we know when economic substance is supposed to be the dominant test or whether there is going to be some kind of weighing involved, and how will we carry out that weighing? These are just a few questions that come to mind in thinking about how to deal with the question of economic substance.

Perhaps I can ask this question of Brian in particular. You'll remember the *Singleton* case, which involved a lawyer who refinanced the equity in his law partnership with borrowed funds and used the equity to buy a house. The Tax Court said, no, no, no, he just borrowed the money to buy the house; interest was not deductible. In our court, the majority said that he borrowed the money to refinance his interest in the law partnership and he used his equity to buy the house. One might say that the economic substance is the financing of the house, or the financing of the law partnership. *Singleton* was not a GAAR case, but if it were, how would we know, how would we be able to figure out, whether one answer or the other is right, applying economic substance?<sup>77</sup>

The judiciary of the United Kingdom has had similar difficulty ascertaining when it is appropriate to rely on the “juristic” meaning of a word, rather than a “commercial” meaning<sup>78</sup>—that is, ascertaining when it is appropriate to rely on “economic substance.”

One way to approach that question is illustrated by the Supreme Court's decision in *Canada Trustco*. Essentially, the court asked whether there was any demonstrable systemic expectation or scheme under Canada's capital cost allowance (CCA) rules to the effect that there should necessarily be consistency between “legal cost” and “economic cost,” such that it may be determined that there is an “abuse” where a taxpayer has entered into arrangements to benefit from an inconsistency in that regard. Given the structure and context of the CCA rules, and their legislative history,

---

77 “The Future of GAAR,” supra note 24, at 4:12-13.

78 See Hoffmann, supra note 24.

the court concluded that there was no such systemic expectation—a conclusion that should not be surprising to anyone who understands the concepts of accelerated depreciation and deferred tax liability.<sup>79</sup> A similar question can be asked in the context of the interpretation and application of our tax treaties: Is there any demonstrable systemic expectation that there should be consistency between “legal benefit” and “economic benefit,” such that it may be determined that there is an “abuse” where a taxpayer has entered into arrangements to benefit from an inconsistency in that regard?

It is submitted that there is no such systemic expectation, for two main reasons. First, it seems clear that there is no general systemic expectation that the members of a company will be treaty residents of the same country as the company, or that the company will bear the same levels of taxation in its country of residence as may be applicable in another country where its source of income is located or in the country or countries where its members reside. Indeed, it is an operating premise of the system that differences will often occur, and the prevalence of this configuration is only increasing with greater globalization.

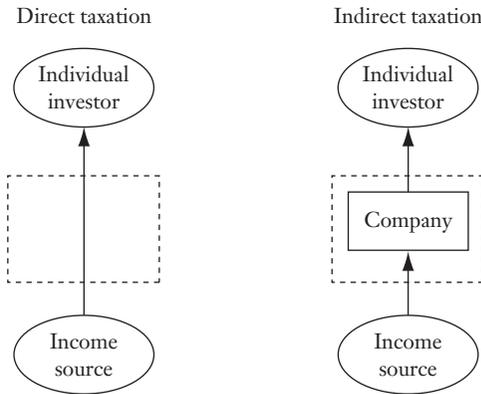
This takes us to the second reason, which is that it remains the expectation of the treaty system erected in accordance with the OECD model that countries may assert tax claims against companies having only “juristic” connections with their territories. Not only does the first sentence (being the first paragraph) of the introduction to the OECD model refer to “juridical double taxation”<sup>80</sup> (and not generally to “double taxation” or to both “juridical double taxation” and “economic double taxation”—although the mutual agreement procedure, notwithstanding its imperfections, can also address the latter),<sup>81</sup> but it seems clear that the paradigm fundamentally reflects no objection whatsoever to the phenomenon of a particular country in which a company is treaty resident (by virtue of being incorporated or centrally managed in that country) asserting substantial tax claims against that company even where the company has no source of income in that country and all the economic benefit of its activities is being derived only by persons who are not residents of that country. Compare the examples in figure 1.

The facts under the heading “Direct taxation” are the same as those under the heading “Indirect taxation,” except for the interposed company. While many comments have been added to the commentary to lament as “unthinkable anathema” (although not in precisely those words) situations in which indirect taxation is more beneficial to the ultimate investor than direct taxation, where are the comments that lament situations in which indirect taxation is more burdensome to the ultimate investor than direct taxation? Moreover, where are the comments that explain or justify in any way why the taxation of the company in such situations by its country of

79 *Canada Trustco*, supra note 4, at paragraph 75.

80 Paragraph 1 of the introduction to the OECD model, supra note 52.

81 See *Chrysler Canada Inc. v. The Queen, MNR, and CRA*, 2008 DTC 6452 (FC).

**FIGURE 1 Taxation of Investment Income—A Comparison**

“artificial residence”<sup>82</sup> is consistent with the principles of taxation based on residence and source, if viewed from the perspective of economic substance? It is submitted that such taxation can be understood and justified only in the context of a systemic expectation that is not premised on consistency between legal substance and economic substance. In other words, the systemic expectation reflected in the OECD model and commentary, which clearly contemplates taxation based on such artificial residence, is not premised on the “lookthrough” paradigm.

Although the addition of references to “beneficial owner” in several of the distributive treaty articles reflects a recognition of the important distinction between legal form and legal substance, there is precious little in those articles that suggests that economic substance rather than legal substance should govern. The distributive articles do not reflect any sword against treaty shopping or double non-taxation that is premised on economic substance, nor even really any significant shield against them, putting aside the “beneficial ownership” requirement (that, somewhat surprisingly, had been held to be lacking in *MacMillan Bloedel Ltd. v. MNR*).<sup>83</sup> But even that only targets inconsistency between legal form and legal substance, not any inconsistency between legal substance and economic substance. Thus, in that context, and in light of the aftermath of the OECD’s harmful tax competition initiative, it seems fair to conclude that, if there is any broad consensus in the international community, it is that these matters should be dealt with, at least at this stage, through greater information sharing (and assistance in collection), and *perhaps* the introduction of more or less specific bilateral treaty measures, and not that the interpretation and

82 As described by Huddleston B in *The Cesena Sulphur Company, Limited v. Nicholson* (1876), 1 TC 88 (Ex. D.), and as discussed in Angelo Nikolakakis, “The Unbearable Lightness of Being Incorporated: The Diminishing Relevance of Corporate Residence,” in Guglielmo Maisto, ed., *Residence of Companies Under Tax Treaties and EC Law* (Amsterdam: IBFD, 2009).

83 79 DTC 297 (TRB).

application of the tax treaties should be governed by some unspecified conception of economic substance informing the application of an equally unspecified doctrine of inherent abuse. This is also reflected in the important comments in paragraph 41 (being the last paragraph) of the introduction to the OECD model, which appears under the heading “Tax Avoidance and Evasion; Improper Use of Conventions.” This paragraph reinforces the view that the elements of the OECD model that are aimed in general at combatting abuses are those relating to information exchange.

This view is also consistent with the historical documents relating to the 1963 OECD draft model tax convention,<sup>84</sup> including the original draft commentary,<sup>85</sup> in which the word “improper” does not even appear and the word “abuse” appears only in the context of the reservation of Switzerland on the article on exchange of information.<sup>86</sup> The draft commentary is in turn consistent with the comments of the OECD Fiscal Committee in its final report on the 1963 draft. In paragraph 54 of that report, the Fiscal Committee said that it had only “recently brought under study the question of the improper use of double taxation Conventions and of the fiscal evasion which can result from the interaction of the Conventions and the domestic laws”; it wished “to see how far it would be necessary to provide bilateral or multi-lateral solutions to this question” and otherwise further consider whether or not the “solutions embodie[d] in the Draft Convention may be subject to augmentation or refinement.”<sup>87</sup> The reference to the question having been recently brought under study is an allusion to Working Party no. 21, which had been formed in 1962<sup>88</sup> both to study the matter and to develop specific treaty provisions to address various concerns that had been raised, including the issue of treaty shopping, which—somewhat ironically—had been raised by the Netherlands. In particular, the Netherlands observed that the distributive articles on dividends, interest, and royalties reflected an “unconditional limitation” on source-country taxation and that this could facilitate tax avoidance through the use of base companies and treaty shopping.<sup>89</sup> This view—in general terms—seems to have been shared by the United States, which advocated

---

84 Organisation for Economic Co-operation and Development, *Draft Double Taxation Convention on Income and Capital* (Paris: OECD, 1963), (herein referred to as “the 1963 draft”). The 1963 draft and the OECD documents cited *infra* at notes 85 through 94 are available online at <http://www.taxtreatieshistory.org>.

85 OECD Council, *Report of the Fiscal Committee on the Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital Among the Member Countries of the O.E.C.D.*, C(63)87 part II (Paris: OECD, July 6, 1963).

86 *Ibid.*, at 124.

87 OECD Council, *Final Report of the Fiscal Committee to Council on the 1963 Draft*, C(63)87 part I (Paris: OECD, July 6, 1963), paragraph 54.

88 See Organisation for Economic Co-operation and Development, *Draft Terms of Reference: Working Party on Tax Avoidance*, TFD/FC/141 (Paris: OECD, January 17, 1952).

89 See Organisation for Economic Co-operation and Development, Working Party no. 12 of the Fiscal Committee, *Note by the Secretary of the Committee*, TFD/FC/104 (Paris: OECD, January 12, 1961).

the insertion of specific treaty provisions.<sup>90</sup> Concerns were also expressed by other countries,<sup>91</sup> but ultimately nothing very much came of the proceedings of Working Party no. 21 (although it does seem to have produced a report, which appears not to be publicly available), apparently because no consensus could be reached.<sup>92</sup> One might also refer to paragraph 53 of the Fiscal Committee's final report, which indicates that the terminology selected for many of the provisions was intended at that stage to derive its meaning from "domestic laws," rather than having "international definitions," although it was also intended that further study in this regard be conducted.<sup>93</sup> Both of these paragraphs were specifically emphasized by the OECD Council in the introduction to its ultimate recommendation adopting the 1963 draft and commentary.<sup>94</sup> It must be recalled that what may be regarded as only one piece of the overall puzzle—the adoption of distributive articles and other measures to eliminate double taxation, with only modest information exchanges to assist administration and compliance—would have been viewed at the time as tremendous departures from the prevailing norm of non-cooperation in the context of international taxation.

It is submitted that this is the essential foundation of the decisions in *Prévost Car* and *MIL*—the absence of a demonstrable systemic expectation that there should be a high degree of consistency between the legal enjoyment of a treaty benefit and the

---

90 See Organisation for Economic Co-operation and Development, *Note by the United States Delegation on Tax Avoidance Through the Improper Use or Abuse of Tax Conventions*, TFD/FC/135 (Paris: OECD, November 14, 1961), and Organisation for Economic Co-operation and Development, *Note by the United States Delegation on Tax Avoidance Through the Improper Use or Abuse of Tax Conventions*, TFD/FC/136 (Paris: OECD, January 14, 1962).

91 See Organisation for Economic Co-operation and Development, *Minutes of the 22nd Session Held at the Château de la Muette, Paris, on Tuesday 17th, Wednesday 18th, Thursday 19th and Friday 20th January, 1961*, FC/M(61)1 (Paris: OECD, February 17, 1961).

92 See, inter alia, Organisation for Economic Co-operation and Development, Fiscal Committee, *Minutes of the 22nd Session Held at the Château de la Muette, Paris, on Tuesday 16th, Wednesday 17th, Thursday 18th and Friday 19th January, 1962*, FC/M(62)1 (Paris: OECD, February 10, 1962); *Minutes of the 4th Session Held at the Château de la Muette, Paris, on Tuesday 8th, Wednesday 9th, Thursday 10th and Friday 11th May, 1962*, FC/M(62)3 (Paris: OECD, June 8, 1962); *Minutes of the 6th Session Held at the Château de la Muette, Paris, on Tuesday 25th, Wednesday 26th, Thursday 27th and Friday 28th September, 1962*, FC/M(62)5 (Paris: OECD, November 6, 1962); *Minutes of the 8th Session Held at the Château de la Muette, Paris, on Tuesday 22nd, Wednesday 23rd, Thursday 24th and Friday 25th January, 1963*, FC/M(63)2 (Paris: OECD, February 13, 1963); *Minutes of the 9th Session Held at the Château de la Muette, Paris, on Tuesday 12th, Wednesday 13th, Thursday 14th, and Friday 15th March, 1963*, FC/M(63)3—part I, TFD/FC/158 (Paris: OECD, March 28, 1963); *Draft Report of the Fiscal Committee to the Council*, FC(63)4, Note by the Secretary of the Committee (Paris: OECD, May 22, 1963); and Working Party no. 14 of the Fiscal Committee (Austria-Sweden), *Second Report on an Article on Exchange of Information*, FC/WP14(62)4 (Paris: OECD, August 6, 1962).

93 *Final Report of the Fiscal Committee*, supra note 87, at paragraph 53.

94 Organisation for Economic Co-operation and Development, Council, *Recommendation of the Council Concerning the Avoidance of Double Taxation*, C(63)113 (Paris: OECD, November 19, 1963).

economic enjoyment of the treaty benefit, or that the enjoyment of a treaty benefit should be premised on the presence of double taxation. Moreover, it is submitted that this conclusion is consistent with the text, context, and purpose of these treaties from a Canadian perspective. In addition, it is submitted that this conclusion reflects an appropriate amount of weight to be accorded to the OECD commentaries, even for subsequent treaties, particularly in light of paragraph 31 of the introduction to the OECD model, which indicates that countries that intend to deal with tax-avoidance matters through the introduction of specific measures in their bilateral treaties need not feel obliged to express formal reservations.

It seems to follow that Canada's tax treaties should not be considered to contemplate any inherent anti-abuse rule that is applicable in general to defeat treaty shopping or double non-taxation, whether as such or as a component of a unified textual, contextual, and purposive interpretation; or, alternatively, that any such inherent anti-abuse rule does not extend to simple treaty shopping or double non-taxation. These are different conclusions, and they may have different implications in general, and in the context of GAAR, as discussed below in greater detail. It should be noted that, outside the context of applying GAAR, the practical implications of the two conclusions are essentially the same with respect to circumstances involving simple treaty shopping or double non-taxation. However, the issue remains an important one because not all circumstances can be reduced to such a characterization. Unfortunately, there does not appear to be a clear consensus among opinion leaders in this area, who rightly caution against being too categorical in this regard.<sup>95</sup> Looking to the foreign jurisprudence, there seem to be inconsistent currents, with the Swiss courts being among the more receptive to the application of judicial doctrines (namely, abuse of rights) to limit what they perceive as abuse,<sup>96</sup> and the Indian courts perhaps leading the charge in the opposite direction.<sup>97</sup> Thus, putting aside very extreme situations, the prevalence of simple treaty shopping and double non-taxation seems to be far too foreseeable to treaty partners for it to be argued credibly that it constitutes an unintended abuse, other than if one is wilfully blind to their "wilful blindness."

---

95 See, for example, David A. Ward, *Access to Tax Treaty Benefits*, research report prepared for the Advisory Panel on Canada's System of International Taxation (Ottawa: Department of Finance, September 2008).

96 See, for example, *A Holdings ApS v. Federal Tax Administration* (2005), 8, part 4 ITLR 536 (Swiss FC).

97 See, for example, *Union of India v. Azadi Bachao Andolan* (2003), 6, part 4 ITLR 233 (India SC). In that case, the Supreme Court, in a series of very lucid observations, acknowledged (at 279) that "[m]any developed countries tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified" and "several of them allow the use of their treaty network to attract foreign enterprises and offshore activities." Moreover, the court noted (at 280) that although this phenomenon "at first blush might appear to be evil," such practices "may have been intended at the time when the . . . DTAC was entered into."

## Foreign Tax Considerations in the GAAR Context

The second important issue addressed by the judicial pronouncements of Bowman J relates to the significance of foreign tax considerations in the specific context of applying GAAR. There seem to be two sides to this coin: the significance of foreign tax considerations as causes or contributing factors in an abuse determination, and their significance as bona fide purposes.

### *Foreign Tax Considerations as Causes of Abuse*

The extent to which foreign tax considerations may be viewed as relevant to an abuse determination in the GAAR context is closely related to the issue of the existence of an inherent anti-abuse rule in the treaty context, but it is not the same issue. It is conceptually possible that there does not exist any inherent anti-abuse rule that is applicable in general to defeat treaty shopping or double non-taxation, or that any such rule does not extend to these phenomena (that is, either of the two conclusions above), *and* that treaty shopping or double non-taxation could nevertheless result in an abuse within the meaning of GAAR. These questions are distinct, as is the question of whether or not the provisions of a treaty could preclude the application of GAAR.

Nevertheless, as Bowman J's logic suggests, to the extent that any inherent anti-abuse rule is applicable to defeat treaty shopping or double non-taxation, it seems that it would be unnecessary—and possibly inappropriate—to apply GAAR. However, there does appear to be a degree of uncertainty as to whether or not the reference to “but for this section” in the operative subsection 245(2) creates a structural ordering here, given the reasons of the Supreme Court of Canada in the *Lipson* case.<sup>98</sup>

Assuming that an inherent anti-abuse rule is not applicable in a particular case to defeat treaty shopping or double non-taxation, the application of GAAR clearly springs into question. In that regard, while it is submitted that all of the relevant facts and circumstances should be considered, the answer in a particular case may depend significantly on certain issues that are common to the inquiry into the applicability of an inherent anti-abuse rule. That is, if one proceeds from the premise that, from a Canadian perspective, treaty shopping or double non-taxation is not abusive in general, it seems to follow that treaty shopping or double non-taxation should not be considered abusive in the context of applying GAAR.

One way that foreign tax considerations may enter into the discussion in this context is through the observation that Canadian taxpayers do quite regularly engage in treaty shopping and arrangements that give rise to double non-taxation in the outbound context, and this with the positive sanction of the Canadian government, as reflected, *inter alia*, in the foreign affiliate income recharacterization rules<sup>99</sup> as

---

98 *Supra* note 12.

99 For example, subparagraph 95(2)(a)(ii) and regulations 5907(11.2)(b) and (c) in respect of the treatment of entities such as disregarded LLCs and Barbados international business corporations.

well as numerous comments over the years by Canadian government officials. Perhaps the most well known of these statements is testimony by David A. Dodge, then deputy minister of finance, in the context of parliamentary proceedings over the controversy that emerged in 1992 following criticisms of the Canadian system by the auditor general:

[I]t is absolutely critical in this modern world, and it becomes more and more critical every day, that Canadian-based companies, companies with their headquarters in Canada, companies with their R and D operations in Canada, companies with their high-value operations here, indeed, stay here and are allowed to compete around the world on an equal footing with companies with headquarters elsewhere in the world. That's the fundamental proposition. . . .

So critical in this government's view and, indeed, critical in the view of governments—increasingly since World War II—is to have a tax regime that doesn't discourage those Canadian firms from going abroad, and does not discourage the Canadians that go abroad from repatriating their incomes so that they can provide jobs here in Canada. The fundamental thing is that we want Canadian firms not to be put on an unlevel playing field, if you will, by our own tax law.<sup>100</sup>

There is also the statement by R. Alan Short, then general director, Tax Policy Branch, Department of Finance, in the context of the same proceedings:

Mr. Chairman, I think the competitive position can be looked at internationally. The rules relating to foreign affiliates are designed to ensure that Canadian-based multinationals are treated in the same way and are not put at a competitive disadvantage in their bona fide business activities—if I can put it in those terms—that they carry on in other countries.<sup>101</sup>

With specific reference to the type of foreign tax-planning arrangements contemplated by regulations 5907(11.2)(b) and (c), there is this clarification from Bob Beith, then senior adviser, Fiscal Policy and Technical Interpretations, Canada Revenue Agency (CRA):

We've drawn to the attention of Finance information we have as to what's going on in the private sector. That would include this example, which I believe is the second example cited by the Auditor General. As far as I'm concerned, it meets the framework of the law and the tax policy. Barbados is a listed country. The interest coming back to Barbados from Europe is active business income, and the dividends flow into Canada tax free. That's the law and the policy as I understand it.<sup>102</sup>

100 See Canada, *Minutes of Proceedings and Evidence of the Standing Committee on Public Accounts*, 34th Parl., 3d sess., 1991-92-93, nos. 37, December 8, 1992; 38, December 10, 1992; 40, February 10, 1993; 43, March 9, 1993; and 48, April 23, 1993 (the 12th Report to the House); and, in particular, issue no. 38, at 38:15.

101 *Supra* note 100, issue no. 38, at 38:15.

102 *Ibid.*, at 38:16.

Finally, on the same subject, Dodge observed:

Mr. Chairman, . . . there is a very important general international issue here. Because we all have different tax systems and different tax laws around the world, there is an opportunity for the taxpayer sometimes to structure his activities in such a way that no tax is paid on income arising from activity in the country abroad where the activity occurs.

That is a problem with the tax laws of the country abroad. We have similar problems that we try to deal with here to ensure that the appropriate tax is paid to Canada by affiliates of foreign companies operating in Canada, and that's our problem. But if there were no mechanisms whatsoever to flow this [income] around, then every foreign company that wanted to operate in France, for example, would be subject to exactly the same regime. They'd pay some French taxes and they would not pay the tax when it comes home.

But there are opportunities to flow income differently, which in fact means that the French government gets less tax revenue on the activity in France, but it does not mean that the Canadian government is in fact losing revenue on that activity. Because structured differently, we would not get any revenue anyway.

So the real question comes down to this issue. Do we want, let's say, Bombardier to be in a position where it cannot avail itself of tax planning opportunities that are available to every other foreign company when operating abroad? Do we want them to be in that position? For many years, the answer to that has indeed been no. The policy of successive governments in Canada has not been to put them in that position. *Our policy has been to work through the OECD, and through other ways, to try to get some better coordination of countries in setting corporate income taxes. But that is a very difficult and not very productive exercise.*<sup>103</sup>

It is clear from these statements by senior government officials that this type of tax planning, although controversial, is not considered to be abusive in the outbound context. Moreover, it is clear from the existence of subsection 93(1) that Canada does not consider efforts to avoid foreign withholding taxes to be abusive. Why, then, should such planning necessarily be considered to be abusive in the inbound context? That would seem to be paradoxical, to say the least, if not simply hypocritical. But it is submitted that these statements take the discussion well beyond the proposition that this type of tax planning should not be considered to be abusive in the outbound context. That is, the last two sentences of Dodge's testimony go straight to the heart of the matter—the absence of a meaningful consensus on these matters among relevant members of the international community, including Canada—from which it seems to follow that simple treaty shopping and double non-taxation in the inbound context should be seen in the same light with regard to the question of abusiveness as in the outbound context. If it is correct that our tax treaties do not really reflect any systemic expectation that a particular company will be owned by members who reside in the same country as the company or that the company will pay any particular

---

103 Ibid., at 38:17 (emphasis added).

level of tax in that country, then it is difficult to see how a Canadian court should conclude that simple treaty shopping or double non-taxation is generally abusive in the context of applying GAAR. This is consistent with the reasons of the Federal Court of Appeal in both *MIL*, where the court was “unable to find such an object or purpose,”<sup>104</sup> and *Prévost Car*, where the court observed the absence of an international or Canadian consensus on a “pejorative view of holding companies.”<sup>105</sup>

Nevertheless, it does not seem to follow necessarily from this that there could never be an abuse in the treaty context to which GAAR may be applicable. It is certainly now clear that subsection 245(2) is intended to be applicable where there is a “misuse of the provisions of . . . a tax treaty” or an “abuse having regard to those provisions . . . read as a whole.”<sup>106</sup> But how does one distinguish cases of *simple* treaty shopping or double non-taxation, which on this premise is not abusive, from cases of *abusive* treaty shopping or double non-taxation?

It is submitted that that the answer to this question may again lie in the logic of *Bowman J.* That is, if *simple* treaty shopping or double non-taxation is not abusive, there must be something more in the relevant facts and circumstances in order to form the foundation of an abuse determination. But what more could there be? Perhaps a “misuse” of a particular treaty provision, or an “abuse” having regard to a particular treaty provision? For that to be the case, there would have to be a particular treaty provision that is circumvented or reflects a scheme that has somehow been offended, along the lines of the logic in *Canada Trustco*. That type of analysis is conceivable, given the prevalence of specific anti-avoidance provisions and certain “subject-to-tax” clauses in Canada’s tax treaties.<sup>107</sup> However, as in the domestic context, it is submitted that it would be necessary to determine first that such specific treaty provision reflected a scheme of some sort—even a narrow one—as opposed to an exception to a more general scheme, because on the latter determination it seems to follow from the logic in *Canada Trustco* that there would be no abuse as contemplated by GAAR.<sup>108</sup>

In that context, it is also conceivable that the presence of foreign non-taxation may be a relevant consideration, but it is submitted that this should not be the case unless it is determined first that the specific treaty provision reflects a scheme or systemic expectation premised on the presence of foreign taxation. Moreover, it is submitted that the existence of such a systemic expectation must be grounded in more than just hearsay, or “did not hear say.” It must be reasonably demonstrable,

104 *MIL*, supra note 38, at paragraph 6.

105 Supra note 45, at paragraph 15.

106 Subsection 245(4), as amended by SC 2005, c. 19, section 52(2), applicable with respect to transactions entered into after September 12, 1988.

107 See, for example, the discussion in Dave Beaulne and Angelo Nikolakakis, “Canada,” in International Fiscal Association, *Cahiers de droit fiscal international 2004*, 58th Congress of the International Fiscal Association, vol. 89a, *Double Non-Taxation* (The Netherlands: IFA, 2004), 235-55.

108 See also the decision in *Donobue Forest Products Inc. v. The Queen*, 2001 DTC 823 (TCC).

and it must amount to more than just a generally desired or anticipated fiscal outcome; it must be grounded in the law. An analogy might be made to the logic of the decision of the Supreme Court of Canada in *Antosko et al. v. The Queen*.<sup>109</sup> *Antosko* was not a GAAR case but a case in which the Crown asserted the position that a deduction under subsection 20(14) should be denied to the transferee of a debt obligation with accrued interest because of the non-taxation of the transferor. The Supreme Court sided with the taxpayer on the following grounds (among others that are not relevant for present purposes):

The respondent characterizes the purpose of s. 20(14) as the avoidance of double taxation. I agree. Section 20(14) operates to apportion accrued interest between transferor and transferee so as to avoid the double taxation that would occur if both parties included all the interest accrued in their respective calculations of income. The interest that has accrued prior to the date of transfer is allocated to the transferor's calculation of income, based presumably on the reasoning that the transferor, as owner of the debt obligation, will be legally entitled to interest up to the date of transfer and that this fact will be reflected in the consideration to be paid by the transferee for the debt obligation. The accrued interest is therefore part of the income of the transferor, and not of the income of the transferee.

The respondent, however, goes on to argue that since amounts received or receivable as interest are included in the calculation of income under s. 12(1)(c), s. 20(14) acts to ensure not only that double taxation is avoided, but also that the entire amount of interest is included in someone's taxable income. *In my view, such an assertion transforms the proposition that the section is meant to avoid double taxation into one that the section is designed to ensure taxation of the entire amount of interest accrued during the taxation year.* This is, however, not true, since if the board as non-taxable owner of the debt obligation did not transfer it, none of the accrued interest would be taxable. *Parliament anticipates just such an outcome in creating a tax-exempt status for certain entities.* Section 20(14) deals with the allocation of interest. Whether the government will ultimately recover tax on that interest is governed by other sections of the Act.<sup>110</sup>

By analogy, it is submitted that in the treaty context, it would be insufficient to point to a particular treaty provision's purpose of avoiding double taxation as proof of some scheme to ensure taxation in either the source state or the residence state; in addition, it would likewise be insufficient to point to a particular entity's tax status in its country of residence, and the non-taxation that may flow from that, as proof of the existence of an abuse of a treaty's distributive provisions. Parliament must have anticipated the general possibility that treaty benefits would flow to certain types of entities with a preferred tax status in their residence state, and with third-country owners. It seems difficult to conclude otherwise in the face of the prevalence of such scenarios, and what must be the deliberate decision of the contracting states to

---

109 94 DTC 6314 (SCC).

110 *Ibid.*, at 6321-22 (emphasis added).

permit each state to determine whether or not, and how, to tax a particular entity by reason of residence, subject only to specific exceptions. These types of scenarios are just too foreseeable to permit acceptance by a court of the proposition that they were not anticipated by Parliament.

In this regard, reference may also be made to the decision of the Federal Court of Appeal in *The Queen v. Imperial Oil Limited*, the case on the large corporations tax (LCT), where the court had difficulty finding a misuse or abuse, despite the finding that the CRA “had anticipated the application of GAAR to prevent improper claims for an investment allowance”:<sup>111</sup>

No doubt Imperial took advantage of a loophole in the statutory scheme, namely the failure to deal with the consequences of different corporate year ends. But, as we have already indicated, that cannot in and of itself amount to a “misuse” of the statutory provisions. Indeed, *it must have been perfectly foreseeable to Parliament* that large corporations would make short term loans to other large corporations which spanned the end of the lender’s financial year, but not the borrower’s, so that both corporations would escape the LCT on the amount of the loans.<sup>112</sup>

By analogy, it should be difficult to establish the existence of an abuse with regard to the enjoyment of treaty benefits in circumstances that are “perfectly foreseeable to Parliament,” even if not generally desired or expected by Parliament. In other words, if the situation is “perfectly foreseeable to Parliament,” it cannot reflect an “un-thinkable anathema” that constitutes a violation of a systemic expectation. Even the Tax Court in *Antle* (discussed below in greater detail) appears to have accepted this logic, stating agreement with the reasons in *Imperial Oil* “that taking advantage of the loophole in and of itself is not abusive: one must analyze whether in so doing, there has been a frustration of the object, spirit and purpose of the provisions in play.”<sup>113</sup>

Moreover, in that regard, it cannot simply be assumed that lack of symmetry or the presence of foreign non-taxation is problematic. For example, in *Haas Estate v. The Queen*, the Federal Court of Appeal made the following comments:

*Kubicek* stands for the proposition that “gain” for purposes of the 1980 Convention is gain that is subject to tax. For Canadian income tax purposes that makes December 31, 1971 (V-Day), the date after which Canada began taxing gains, relevant for purposes of Article XIII(9). While the purpose of the Convention is to avoid double taxation and, as counsel for the appellant argued, while the Convention is to be reciprocal, *there will still be provisions of United States and Canadian law that will yield different results in their application for Canadian and United States taxpayers*. For example, tax rates in each country may be different; in the United States there is no deemed disposition on death for

111 2004 DTC 6044, at paragraph 61 (FCA).

112 *Ibid.*, at paragraph 79 (emphasis added).

113 *Supra* note 6, at paragraph 102.

capital gain tax purposes as there is in Canada. Thus, perfect symmetry will not be achieved by the 1980 Convention.<sup>114</sup>

This should not be surprising, nor would it be something that is unanticipated by the OECD model and commentary, given the interpretive framework reflected by article 3(2) of the model. Less than perfect symmetry in tax statutes is a phenomenon with a long pedigree, both in the cross-border context and purely domestically—an observation that finds support in the views expressed by the Supreme Court of Canada in *The Queen v. Malloney's Studio Limited*:

Mutuality of tax treatment of parties to the same transaction, or even the avoidance of double taxation have never been principles with which the draftsmen of taxing statutes have ever regarded themselves as saddled. Indeed, “fairness and realism” have never been the governing criteria for the interpretation of taxing statutes.<sup>115</sup>

Although the tone of these comments was perhaps overly influenced by the court’s reliance on the perspective laid out in *Partington v. Attorney-General*<sup>116</sup> (which was referred to in this context), the substantive point remains. As noted in *Antosko and Imperial Oil*, perfect symmetry is not necessarily a systemic expectation.

The comments of the Federal Court of Appeal in *Federated Co-operatives Limited v. The Queen* (another LCT case) are also quite apposite:

I agree with the appellant that the definition of “investment allowance” must be interpreted, if possible, so that it has its intended effect. I also agree that there are similarities between the definition of “taxable capital” and the definition of “investment allowance” from which it might be inferred that Parliament, as a matter of policy, has tried to avoid taxing the same capital twice.

However, the definition of “taxable capital” is not a mirror image of the definition of “investment allowance.” Even where the two definitions are similar, the amounts described in each definition may not be the same. For example, the liability of a debtor under a particular debt instrument may exceed the carrying cost of a debt investment that is acquired at a discount.

In addition, it must be recognized that where it is appropriate to consider matters of policy to assist in the interpretation of a statute, *all relevant policy matters must be taken into account*. It would appear from a review of Part I.3 as a whole that *the avoidance of what the appellant refers to as double taxation is not the only policy consideration* that may bear on the issues in this case.<sup>117</sup>

This again is not a treaty case, but it is instructive for the purposes of determining systemic expectation, and distinguishing the general desire or purpose of eliminating double taxation from the existence of an overriding systemic expectation to the

114 2001 DTC 5001, at paragraph 2 (FCA) (emphasis added).

115 79 DTC 5124, at 5129 (SCC).

116 (1869) LR 4; E & I App. HL 100.

117 2001 DTC 5414, at 5417 (FCA) (emphasis added).

effect that factual double taxation must be present. Reference may also be made to the decision of the Federal Court of Appeal in *The Queen v. Brelco Drilling Ltd.*,<sup>118</sup> where it was held that “exempt deficits” should not be netted against “exempt surplus” in determining safe income under the statutory rule in paragraph 55(5)(d).

In addition, in the somewhat closer context of the deduction in respect of foreign taxes under subsection 20(12), reference may be made to *Taylor v. The Queen*,<sup>119</sup> where the Federal Court Trial Division rejected the Crown’s attempt to cut down the scope of the provision on the basis of an implied premise or systemic expectation requiring the presence of double taxation. The court first noted the argument of counsel for the Crown that

subsection 20(12) is contained in the Act in order to prevent double taxation and if there is no double taxation, which there admittedly was not in this matter, there can be no relief given under subsection 20(12).

Finally [Crown counsel] argues that to give the interpretation sought by the plaintiff would give rise to an absurd result which is contrary to the general scheme of the Act and that is to be avoided if at all possible.<sup>120</sup>

The court responded to those arguments as follows:

I do not agree with any of these submissions. . . .

While the result of interpreting the legislation this way might be unusual in that the plaintiff appears to be obtaining tax relief that perhaps was not contemplated at the time the legislation was enacted, I do not find the result absurd. . . .

That is not the way the draftsman wrote it. Nor is that the way it is to be interpreted.<sup>121</sup>

Sometimes the asymmetry benefits the taxpayer and sometimes it does not, and one cannot assume or even reasonably infer that this result is absurd or abusive from the simple premise that the general purpose of a statute is to eliminate double taxation. In this regard, it is also interesting (and entertaining, if not greatly instructive) to refer to *The Queen v. Kurisko*,<sup>122</sup> in which the plaintiff, who was a judge, asserted the unconstitutionality of required contributions to the judges’ pension scheme, in significant part on the theory that this requirement resulted in double taxation of the judiciary!

It also appears to be unexceptional to suggest that there is no abuse where a taxpayer takes advantage of a treaty provision that creates a deliberate tax incentive—

118 99 DTC 5253, at paragraphs 17-24 (FCA).

119 88 DTC 6422 (FCTD).

120 *Ibid.*, at 6425.

121 *Ibid.*, at 6425-26.

122 88 DTC 6434 (FCTD); *aff’d*. 90 DTC 6376 (FCA); leave to appeal to the Supreme Court of Canada refused.

such as a tax-sparing provision—at least not by reason of any difference between the tax in fact paid and the tax deemed to be paid, since the whole point of such a rule is to facilitate this difference, as the incentive. However, that too has been debated.<sup>123</sup>

This logic was also accepted by the Tax Court in *Garron*.<sup>124</sup> This case involved the taxation of certain trusts and various Canadian-resident taxpayers, where the benefit of an exemption from Canadian taxation was claimed by the trusts under article XIV of the Canada-Barbados income tax convention<sup>125</sup> in respect of a disposition of taxable Canadian property. As against the trusts, the Crown asserted that they were in fact resident in Canada, that the deemed residence rule in section 94 of the Act applied, and that GAAR also applied, on the theory that there had been an abuse of the Barbados treaty. As against the Canadian principals, the Crown asserted that the attribution rule in subsection 75(2) of the Act applied, as well as GAAR, but not in respect of the application of the Barbados treaty. Apparently, all parties agreed that only the trusts could assert claims arising by virtue of the Barbados treaty, so no arguments were made by them in this regard in respect of the positions of the other taxpayers. The Tax Court's conclusions with respect to the relationship between the provisions of the Barbados treaty and subsection 75(2) are considered below. For present purposes, the focus will be on the court's conclusions with respect to the application of GAAR. It should also be noted that the court's comments in this regard should not be considered to constitute ratio, since the matter was decided on the basis that the trusts were in fact resident in Canada.

With regard to the application of GAAR, the court held that no abuse of the Barbados treaty had been established, rejecting several arguments put forward by the Crown, which the court summarized as follows:

In reference to the Treaty, the Minister submits that there was an abuse of Article XIV(4). The following arguments were made:

- (a) it is an abuse of the Treaty to avoid an anti-avoidance rule such as s. 94;
- (b) Article XIV(4) of the Treaty is designed to exempt only true non-residents of Canada;
- (c) the Treaty was not intended to exempt foreign accrual property income (FAPI);
- (d) Article XIV(4) is only intended to prevent double taxation; and
- (e) the Treaty was not intended to permit such an erosion of the Canadian tax base that could occur with the widespread use of this type of planning.<sup>126</sup>

123 See, for example, Deborah Toaze, "Tax Sparing: Good Intentions, Unintended Results" (2001) vol. 49, no. 4 *Canadian Tax Journal* 879-924.

124 *Supra* note 26.

125 Agreement Between Canada and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Bridgetown on January 22, 1980 (herein referred to as "the Canada-Barbados treaty").

126 *Garron*, *supra* note 26, at paragraph 357.

In rejecting these arguments, the court stated:

It does not make sense that a transaction that is subject to tax under the Act by virtue of an anti-avoidance provision necessarily constitutes a misuse or abuse of the Treaty.<sup>127</sup>

To elaborate on the court's reasoning, it should be noted that the first item addressed was the question of the implications of the OECD commentary. The court began with the observation that "the Minister's position is contrary to commentary published by the OECD in 1977."<sup>128</sup> The court then observed that the 1977 commentary—in particular, paragraph 7 under article 1—in fact suggested that "treaties should be amended to take into account domestic tax avoidance legislation."<sup>129</sup> The court also observed<sup>130</sup> that the comments of Bowman J in *RMM Canadian* with respect to situations of potential abuse had to be understood in light of his subsequent comments in *Evans*,<sup>131</sup> where he cast some doubt on the premises of his own analysis as a result of the decision in *Canada Trustco*. The court also rejected the Crown's arguments based on the lack of substantive connections between the trusts and Barbados. In this regard, the court noted a "problem . . . with this argument," namely that, "if accepted, it would result in a selective application of the Treaty to residents of Barbados, depending on criteria other than residence."<sup>132</sup> In other words, in light of the test for residence under the Barbados treaty, which did not second-guess a contracting state's practices concerning the determination of liability to tax based on residence as a function of extraneous considerations such as the residence of the taxpayer's ultimate economic beneficiaries, the court had difficulty with the notion that any abuse could be established on this basis. The court also categorically rejected the Crown's position that the treaty exemption should be restricted to situations in which there is double taxation.<sup>133</sup> Interestingly, in this regard, the court referred only to the decision of the Federal Court of Australia in *FC of T v. Lamesa Holdings BV*<sup>134</sup> and the decision of the UK High Court of Justice in *Smallwood v. R & C Comrs*.<sup>135</sup> However, it is clear that the court's reasons were premised on the decision in *MIL*,<sup>136</sup> which was cited for the proposition that the Federal Court of Appeal was unable to find any object or purpose the abuse of which would justify a

127 Ibid., at paragraph 373.

128 Ibid., at paragraph 374.

129 Ibid., at paragraph 375.

130 Ibid., at paragraph 378.

131 Supra note 14.

132 *Garron*, supra note 26, at paragraph 381.

133 Ibid., at paragraphs 389-91.

134 97 ATC 4752, at 4755 (Full FC).

135 [2009] EWHC 777, at paragraph 40 (Ch.).

136 See *Garron*, supra note 26, at paragraphs 361 and 391.

departure from the consequences otherwise flowing from a straightforward interpretation and application of the words of the provision that accorded the treaty exemption in question.

In contrast, it may be (for example) that arrangements designed to circumvent ownership thresholds contemplated by specific treaty provisions, such as the limitation-on-benefits (LOB) article (XXIX A) in the US treaty, could be considered to be abusive in certain circumstances. An arrangement of this type was described in example 16 of the explanatory notes to subsection 96(6) released in 1995<sup>137</sup> in relation to Bill C-70.<sup>138</sup> The example involved a 10 percent interest in a foreign entity acquired under a repurchase arrangement for the purpose of creating foreign affiliate status and thereby transforming the treatment of income that would otherwise be taxable. In such a context, it is certainly conceivable that a court could determine that the ownership threshold was “circumvented.” Of course, other examples are also conceivable.

A more difficult example involves circumstances and issues such as those considered by the Tax Court in *Antle*.<sup>139</sup> Like *Garron*, *Antle* was a non-resident trust case, in which both the trust and a Canadian-resident taxpayer who had transferred taxable Canadian property to the trust were assessed in respect of a capital gain from the disposition by the trust of the property, in relation to which the trust had claimed the benefit of an exemption from Canadian tax under the Barbados treaty. It was the position of the taxpayers that no abuse had been established in the circumstances, either of or having regard to any provision of the Barbados treaty or of the Act. Of course, the Crown had a different view of the matter, including the view that the trust had not been validly constituted, which is the view that carried the day with the court. However, the court also proceeded to address the potential application of GAAR. Interestingly, the court seems to have rejected the view that an abuse of the Barbados treaty had been established in relation to the application of the treaty to the trust, but nevertheless proceeded to conclude that the implementation of the arrangements in question constituted “an abuse of the Act, of the Treaty and of the joint operation of both”<sup>140</sup> in relation to the other taxpayer, Mr. Antle.

It is important to examine the court’s reasons in this regard. Essentially, the court concluded that what had been misused or abused was the deemed residence rule in section 94 of the Act, together with the rollover rule for spousal trusts under subsection 73(1) and the treaty exemption.<sup>141</sup> Although the court methodically addressed over 10 separate arguments put forward on behalf of the taxpayers, its basic logic may be summarized as follows. First, the rollover rule for spousal trusts under subsection 73(1) applies only to resident trusts, and is intended to accord deferral until the

---

137 Canada, Department of Finance, *Amendments to the Income Tax Act: Explanatory Notes* (Ottawa: Department of Finance, February 1995).

138 Enacted as SC 1995, c. 21.

139 *Supra* note 6.

140 *Ibid.*, at paragraph 120.

141 *Ibid.*, at paragraphs 117-122.

relevant property exits the marital unit. Thus, the rollover rule would not normally apply to a non-resident trust (and was eventually amended to exclude section 94 trusts). Second, section 94 deems certain trusts to be resident in Canada, for the purpose of preventing tax avoidance by Canadian residents in respect of certain items of income and gain where relevant property is acquired by non-resident trusts. Third, the arrangements in question used the deemed residence rule—an anti-avoidance rule—to achieve tax avoidance, by facilitating a rollover in favour of a trust that is treated as a resident of Canada for the purposes of the Act but as a non-resident for treaty purposes. Fourth, this use of section 94 and subsection 73(1), and of the treaty exemption as part of that planning, constituted a misuse or abuse within the meaning of GAAR, on the basis that the avoidance of such taxation by Canadian residents is an outcome that these provisions seek to prevent, and that this planning defeats the underlying rationale of these particular provisions and Canada’s policy of taxing capital gains more generally, as well as the purpose of the treaty exemption.

Arguably, the structure of the court’s logic is not unlike that of the Supreme Court of Canada in *Kaulius*,<sup>142</sup> where it was considered a misuse of a stop-loss rule to use it for the purpose of transferring losses to unrelated parties, or that of the Quebec Court of Appeal in the interprovincial context in *OGT Holdings Ltd. v. Quebec (Deputy Minister of Revenue)*,<sup>143</sup> where it was considered to be a misuse or abuse of the rollover rule (for transfers to corporations in exchange for shares) to use that rule, in combination with other rules, to achieve tax avoidance going beyond tax deferral. It is also somewhat similar to the view of the majority of the Supreme Court in *Lipson*,<sup>144</sup> where it was considered to be a misuse or abuse of the spousal attribution rules to achieve tax avoidance. However, the main difficulty lies in reconciling the court’s views on the abusiveness of Canadian residents enjoying the indirect benefit of the Barbados treaty with the views expressed in most other decisions that there is no object or purpose that limits the enjoyment of indirect benefits by non-residents of the relevant treaty country (that is, treaty shopping), including the comments in *Garron* suggesting that such a conclusion effectively creates two classes of Barbados “residents” under the treaty. Is there a meaningful distinction (in the context of a unified textual, contextual and purposive interpretation) between the enjoyment of indirect treaty benefits by third-country residents and the enjoyment of such benefits by Canadian residents? Perhaps, or perhaps not, and it may be that such or a similar distinction can be traced back to certain versions of the OECD commentary, particularly the distinction made between base company (outbound) situations and conduit company (inbound) situations, but no such important distinction seems to be reflected in the commentary before the 1992 revisions or after the 2003 revisions. The court did refer to paragraph 9 of the commentary on

---

142 *Supra* note 3 (SCC).

143 2009 DTC 5048 (Que. CA).

144 *Supra* note 12.

article 1,<sup>145</sup> which seems to have survived the various revisions intact, but this particular paragraph does not seem to reflect this type of distinction. Another difficulty lies in reconciling the court's comments on the relevance of non-taxation<sup>146</sup> with those expressed in the other jurisprudence, again including *Garron*. We will have to wait and see what may come from a further consideration of *Antle*, the Achilles heel of which is probably reflected in the comments where the court characterizes the effect of GAAR as being to confer on the courts a "wide legislative authority"<sup>147</sup>—an interpretation that surely must be wrong.

Another difficult (or at least more peculiar) example (or set of examples) involves arrangements designed to avoid the application of rules such as those in relation to fiscally transparent entities in article IV(7) of the US treaty. In that regard, it seems appropriate to note that the experience to date with that provision suggests very strongly that structural and conceptual defects in specific treaty provisions could render it very difficult, if not impossible, for a court to discern any coherent scheme that could form the foundation of an abuse determination in the GAAR context. However, that is the subject of a separate paper<sup>148</sup> and will not be pursued further here.

### *Foreign Tax Considerations as Bona Fide Purposes*

In *RMM Canadian*, Bowman J expressed the view that GAAR had to be applied from a Canadian perspective, such that foreign tax considerations might not save a transaction that might otherwise be considered to be abusive from a purely Canadian perspective. His precise comments were as follows:

The second question is whether the transaction, albeit resulting in a tax benefit, is removed from subsection 245(3) because it:

may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

The argument is that since there was apparently more tax saved in the United States than in Canada by selling the shares of EL the primary purpose was not to obtain the tax benefit (i.e. the avoidance of Canadian tax) but to save U.S. taxes. It is not merely a matter of comparing dollars saved on one side of the border or the other. I do not think that it has been established that the saving of U.S. taxes was a predominant purpose here. The entire thrust of EC's endeavours was to save the Canadian withholding tax. The U.S. tax advantages were, at least on the evidence before me, not formulated with the precision and clarity that the Canadian tax advantages were. Rather they appeared to be more in the nature of an *ex post facto* rationalization. Moreover the witnesses who did testify appeared to be one or more steps removed from the formulation of the

145 *Antle*, supra note 6, at paragraph 96.

146 *Ibid.*, at paragraph 101.

147 *Ibid.*, at paragraph 122.

148 See Darmono and Nikolakakis, supra note 49.

corporate fiscal policies. In any event, I am not prepared to say that because a U.S. tax saving that is greater than the Canadian tax saving is envisaged or achieved by a Canadian tax avoidance scheme this in itself takes the transaction outside the ambit of section 245. A particular transaction the purpose of which is the avoidance of Canadian tax may well have international fiscal implications. Section 245 operates within the context of Canadian tax law and it is within that context that the primary purpose is to be determined. The appellant's position appears to be that where an avoidance transaction in Canada results in greater inroads being made against the U.S. fisc than against the Canadian fisc the primary purpose cannot be the avoidance of Canadian tax. I do not accept that.<sup>149</sup>

There is much to be said about these relatively succinct observations, in addition to the comments made earlier in this article.

First, it should be noted that Bowman J's observations were considered by the Tax Court in *Univar Canada Ltd. v. The Queen*.<sup>150</sup> This was a case involving what has been characterized by the Crown as an "indirect loan"—an arrangement whereby a Canadian corporation acquires shares of a foreign affiliate that holds indebtedness of another qualifying non-resident corporation, in circumstances where the interest on the indebtedness would have been taxable in Canada if earned directly but is effectively exempt in the form of "exempt surplus" dividends from the foreign affiliate, and often with the additional wrinkle of a Canadian interest deduction in respect of indebtedness incurred in relation to the acquisition of the foreign affiliate shares. There has been a great deal of controversy in this context. The CRA has made a series of statements over a period of many years to the effect that it would consider such arrangements to be abusive in certain circumstances, but ultimately only to the extent that the "borrower" non-resident corporation is sufficiently outside what has come to be referred to as the "Canadian cone." If it sounds as if we are beginning to get beyond the realm of legal analysis, there is good reason for that. But more importantly for present purposes, in *Univar* it was argued by the Crown, on the basis of the comments in *RMM Canadian*, that foreign tax considerations and even foreign non-tax considerations should be disregarded in the context of the GAAR analysis, to the extent that they are "extraneous to the Appellant as a tax paying Canadian entity."<sup>151</sup> This was not accepted by the court:

Authorities for propositions must be carefully presented in the full context of the decision upon which those propositions are based. *RMM*, the Appellant, which was to be wound-up with a distribution dividend being subject to withholding tax, together with its U.S. parent company, arranged instead, a convenient purchase of the Appellant's shares. This transaction was designed to reduce both Canadian and U.S. income tax.

The distinctions between the *RMM* decision and this case are:

---

149 *RMM Canadian*, supra note 15, at 312.

150 2005 DTC 1478 (TCC).

151 *Ibid.*, at paragraph 53.

- (1) In this case there was no tax to be saved such as the Canadian withholding tax.
- (2) The above quote acknowledges the existence in *RMM* of a “Canadian tax avoidance scheme.” I have concluded that there was no avoidance transaction in this case.
- (3) The latter part of the quote states that section 245 operates within the context of Canadian tax law and it is within that context that the primary purpose is to be determined. This cannot be interpreted to mean that one must not consider the *entire* fact situation in whatever geographical location, relating to and giving rise to the decisions made and the transactions implemented by a Canadian tax paying entity.
- (4) There is no argument in this case that more tax was saved in any country or countries other than in Canada and that the primary purpose, was not, therefore, to obtain a Canadian tax benefit.
- (5) The witnesses who testified in this case included the three gentlemen, Pruitt, Lundberg and Tole who were intimately familiar with the facts surrounding what took place, as stated herein.<sup>152</sup>

Putting aside the “distinctions,” it is submitted that only point 3 is important for present purposes—in the sense that it directly addresses the question at hand. It is true that Bowman J’s comments reflect a degree of dissatisfaction with the evidence surrounding the factual proposition, which explains his reference to the foreign tax considerations in *RMM Canadian* being “more in the nature of an *ex post facto* rationalization,” but he does eventually get to the legal issue. What he says about that is that GAAR “operates within the context of Canadian tax law and it is within that context that the primary purpose is to be determined.” He also says that, in making this determination of the primary purpose, “[i]t is not merely a matter of comparing dollars saved on one side of the border or the other.” He does not actually say that any of the relevant facts and circumstances should be disregarded, and in that sense the comments from *Univar* in point 3 above appear to be perfectly fair, in that it does indeed seem inappropriate to interpret Bowman J’s comments to mean that one must not consider the entire fact situation.

How, then, should Bowman J’s comments in *RMM Canadian* be interpreted, and is there any merit in the Crown’s position in *Univar*? In this regard, it is submitted that there is no logical incompatibility between considering all of the relevant facts and circumstances, including foreign tax considerations, and determining the primary purpose of a transaction within the context of Canadian tax law. It is also submitted that there is no logical incompatibility between considering the relative amounts of the tax savings on each side of the border and not reducing the exercise to no more than merely a matter of comparing dollars saved on one side of the border or the other. Moreover, it is submitted that in the context of a rule such as GAAR—which is premised on the possibility of the existence of mixed motivations, which is intended to be applied in the cross-border and treaty contexts, and which

---

152 *Ibid.*, at paragraphs 55-56.

contains a deliberate exclusion from “avoidance transaction” status for transactions that may have a “tax benefit” (that is, Canadian tax savings) as one of their driving forces if the “transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit”<sup>153</sup>—a unified textual, contextual, and purposive interpretation would admit of not only the relevance of foreign tax considerations, but also the possibility that they may constitute *bona fide* purposes other than to obtain a tax benefit.

This is not a controversial statement in certain outbound contexts where the purpose of securing foreign tax savings is often relied upon as a *bona fide* purpose other than to obtain a tax benefit. While it is conceivable that there may be circumstances where attempts to secure foreign tax savings might not be considered to be *bona fide* from a Canadian perspective, it is submitted that it is unarguable that the purpose of securing “legitimate” tax savings *cannot* be a *bona fide* purpose, or that any distinction in this regard should be drawn between foreign and Canadian tax savings. Nevertheless, even if both can be *bona fide* purposes, the purpose of securing Canadian tax savings, whether or not *bona fide*, is obviously not a purpose other than to obtain a “tax benefit,” with the variety of implications that this may have more generally.<sup>154</sup> However, since foreign tax savings cannot constitute a “tax benefit,” if they are *bona fide* and they are in fact the primary driver behind a transaction, then it is submitted that there is no obvious reason why they should be disregarded or even discounted in determining the primary purpose of a transaction within the context of Canadian tax law. It is Canadian tax law that has adopted this distinction between transactions that are primarily driven by securing a tax benefit and those that are primarily driven by other *bona fide* purposes, and there is no compelling textual, contextual, or purposive justification for distinguishing between different *bona fide* purposes. GAAR does not establish a business purpose test—let alone an even narrower Canadian business purpose test—as contended, in essence, by the Crown in *Univar*.

On the other hand, the jurisprudence is also fairly clear that the purpose of each transaction must be tested separately, and cannot simply be imputed from the purpose of any overall series of transactions.<sup>155</sup> Thus, it is conceivable that the principal purpose of a particular transaction within a series may be to secure Canadian tax savings while the principal purpose of the overall series may be to secure foreign tax savings. In that context, it seems that the presence of foreign tax savings as the principal purpose would likely not prevent the particular transaction from being regarded as an avoidance transaction under GAAR, although it could perhaps be a factor in concluding that no abuse arises in the circumstances. It is only where the principal

---

153 *Univar*, supra note 150, at paragraph 48.

154 See the discussion in Angelo Nikolakakis, “Who, What, Where, When, Why, and How—Discerning an Avoidance Transaction,” Policy Forum (2009) vol. 57, no. 2 *Canadian Tax Journal* 294–306.

155 See *The Queen v. MacKay et al.*, 2009 DTC 5092 (FCA).

purpose of the *particular transaction* (that results, or is part of a series that results, in a tax benefit) is to secure foreign tax savings (or other bona fide purposes other than to obtain the tax benefit) that this issue properly arises in the context of the avoidance transaction determination.

In that context, while the exercise may have to amount to more than a mere numerical comparison, it seems equally appropriate to do more than just pay lip service to the possibility that securing foreign tax savings can be a bona fide purpose. Rather, it is submitted that the appropriate legal weight should be given to this and each other relevant factor as part of the analytical process, in accordance with its factual weight in the decision-making process. It is submitted that a statutory test for an avoidance transaction requires a determination on the following question: What, in fact, was the relative weight of the purpose of securing a tax benefit versus other bona fide purposes—including, in the cross-border context, securing foreign tax savings?

### Incompatibility of GAAR and Treaty Provisions

It does not appear to be a foregone conclusion that the application of GAAR could be incompatible with the provisions of a tax treaty. However, that is not to say that there necessarily would be such an incompatibility. Moreover, many of the issues that previously arose in this area have been resolved by the introduction of section 4.1 of the ITCIA:

4.1 Application of section 245 of the Income Tax Act—Notwithstanding the provisions of a convention or the Act giving the convention the force of law in Canada, it is hereby declared that the law of Canada is that section 245 of the *Income Tax Act* applies to any benefit provided under the convention.

Together with the amendments to GAAR in relation to treaty benefits, it seems to be settled that GAAR can displace the application of the provisions of a tax treaty and the tax benefits that would otherwise flow from those provisions, even if the application of GAAR goes beyond definitional and contemplated characterization matters.

In the era before these amendments, some commentators had expressed the contrary view.<sup>156</sup> Moreover, Bowman J had observed in *RMM Canadian* that “[t]he argument is certainly not without merit.”<sup>157</sup> Ultimately, however, he concluded, as noted above, that GAAR could apply with the effect of bringing a transaction within the ambit of subsection 84(2) or section 212.1, given what he described as “the obvious purpose” of the ITCIA.<sup>158</sup>

---

156 See Tremblay, *supra* note 64, as well as Carl F. Steiss, “Issues Relating to Tax Treaties,” in *Report of Proceedings of the Forty-Fifth Tax Conference*, 1993 Conference Report (Toronto: Canadian Tax Foundation, 1994), 45:1-33.

157 *Supra* note 15, at 315.

158 *Ibid.*

Nevertheless, and although the comments of Bowman J in *RMM Canadian* were made before the changes to the ITCIA concerning GAAR, it appears that there continues to be a degree of uncertainty in this regard in the jurisprudence, at least in some respects and, in particular, in the broader context concerning the application of other anti-avoidance rules. That is, in the two recent decisions in *Garron* and *Antle*, the Tax Court has come to what may be conflicting conclusions as to the relationship between tax treaties and other anti-avoidance rules in the Act, as well as the effect of section 4.1 of the ITCIA.

In *Garron*, the court suggested that the application of section 94 may be incompatible with the Barbados treaty,<sup>159</sup> and even concluded that this would be the case with reference to the application of subsection 75(2).<sup>160</sup> The theory may be summarized as follows. First, article XIV(4) of the Barbados treaty speaks in absolute terms: “Gains from the alienation of any property, other than those mentioned in paragraphs 1, 2 and 3 *may be taxed only* in the Contracting State of which the alienator is a resident [emphasis added].” Thus, in principle, and subject to any specific exceptions laid out in the treaty, these gains simply cannot be taxed by Canada—in the hands of any taxpayer. Second, while there is one exception, in article XXX(2) of the treaty, this extends only to attribution under section 91 of the Act, and not to attribution under subsection 75(2) (nor does it save the application of section 94).

In contrast, in *Antle*, as noted above, the court concluded that the Barbados treaty did not preclude the application of GAAR in respect of Mr. Antle, rejecting the taxpayer’s position that the statute implementing the Barbados treaty should prevail over the ITCIA, which had been advanced on the basis of the observation that certain similar statutes (implementing other tax treaties) had been amended to specify that they do not prevail over the ITCIA, but not the one for the Barbados treaty.<sup>161</sup> This position was rejected by the court on the basis that the ITCIA provision “is more specific, later in time and crystal clear as to its intent and effect. It governs. GAAR can apply to the Treaty.”<sup>162</sup> This latter point is likely correct, although its implications are not entirely certain, particularly with regard to the application of other anti-avoidance rules. Moreover, the proper analysis of these issues may depend on the manner in which the relevant rule operates. That is, subsection 75(2), for example, purports to attribute to another person the very income of the trust. In contrast, a rule such as section 17 imputes what is arguably a notional amount of income. Somewhere in between, there are rules such as section 91, which imputes income determined by reference to underlying FAPI but does not actually attribute the FAPI as such.

159 *Garron*, supra note 26, at paragraph 394.

160 *Ibid.*, at paragraphs 327-340, relying in part on the discussion in Robert Couzin, *Corporate Residence and International Taxation* (Amsterdam: International Bureau of Fiscal Documentation, 2002), at 235-38.

161 *Antle*, supra note 6, at paragraphs 86-87.

162 *Ibid.*, at paragraph 87.

In addition, it seems appropriate to refine the inquiry as one as to whether the application of the rule in question is compatible or not with a particular treaty provision (as opposed to with treaties in general or even with a particular treaty in general), given (for example) provisions such as the definition of “dividends” in most treaties, which specifically contemplates some variation on the theme of “income subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is a resident,” as noted by Bowman J in *RMM Canadian*.<sup>163</sup> While the precise scope of such definitional extensions is far from certain, they must have some content, and it seems not at all obvious why that content could not be supplied through the application of GAAR or any more specific anti-avoidance rule, as opposed to a mere characterization or recharacterization rule.<sup>164</sup>

## CONCLUSIONS

This article has attempted to examine a number of important issues related to determining the relevance and evaluating the significance of foreign tax considerations (including situations involving treaty shopping and double non-taxation) in the context of the interpretation and application of GAAR, primarily through the rubric of Bowman J’s judicial pronouncements in this regard. Overall, it seems that he had it correct, at least so far, although time will have to be the ultimate judge of that.<sup>165</sup>

Through this review, it emerges that the evolution undoubtedly occurring in the perspectives of members of the international community (including Canada) with regard to the proper treatment of holding companies and other such traditional tax-planning arrangements has not crystallized into any real consensus. Although the OECD model and the various versions of the commentary have consistently reflected concerns over international tax planning (though at different intensities and with different priorities in different eras), it seems inappropriate to conclude that there has ever been any real consensus that these arrangements do in fact constitute an abuse of the treaties, or that these concerns should be addressed through the acknowledgment and application of an inherent anti-abuse rule, or any rule or principle of general application that premises entitlement to treaty benefits on the presence of double taxation or the absence of double non-taxation. Indeed, it is submitted that the OECD model and commentary, and the treaties that follow that model, do not reflect any reasonably demonstrable systemic expectation that a company that qualifies as

---

163 *Supra* note 15, at 314.

164 In this regard, reference may also be made to Jinyan Li and Daniel Sandler, “The Relationship Between Domestic Anti-Avoidance Legislation and Tax Treaties” (1997) vol. 45, no. 5 *Canadian Tax Journal* 891-958, as well as the long list of literature cited therein.

165 This is not to say that the application of Bowman J’s approach to the facts and circumstances prevailing in *RMM Canadian* was correct, given his comments in *Evans*, and what further has been said and may yet be said by the courts (about the “scheme” and establishing the “scheme”) in other surplus-stripping cases, including *Coptborne Holdings Ltd. v. The Queen*, 2009 DTC 5918 (FCA), leave to appeal to the Supreme Court of Canada granted January 28, 2010, docket no. 33283; and *Canada v. Collins & Aikman Canada Inc.*, 2010 FCA 251.

a resident of a contracting state will be owned primarily or to any particular extent, if at all, by residents of that state, or that it will be subjected to any particular level of taxation by reason of residence under the laws of that state. In that context, it is submitted that it is not only foreseeable but a certainty that there will often be situations in which there will not be a strong relationship between the direct enjoyment of treaty benefits from a legal perspective and the indirect enjoyment of treaty benefits from an economic perspective. Thus, it is submitted that it cannot really be a systemic expectation that treaty benefits will be enjoyed (from both a legal and an economic perspective) only or even primarily by residents of the particular country who are subjected to comprehensive levels of taxation comparable to those imposed in the source country. That might be generally desired and generally anticipated, at least over the long run, but it should not be sufficient to form the foundation of a systemic expectation with legal consequences.

In brief, it is submitted that the systemic expectation reflected in the OECD model and commentary, and treaties that follow that model, is simply not premised on the lookthrough principle. This is obvious in the context of the prevalence of, and proffered justifications for asserting, comprehensive taxation against corporations on the basis of their “artificial residence”—that is, regardless of the residence of their ultimate economic beneficiaries—and it is also clear from the most fundamental aspect of the OECD model, which is that it is aimed primarily at the problem of juridical double taxation, not (with some exceptions) economic double taxation. Moreover, it is clear that many of the revisions to the commentary describing solutions in relation to the application of tax treaties in the context of partnerships, base companies, and conduit companies, and certain other contexts, represent a considerable gloss on the previously accepted and “higher-fidelity” interpretations of the relevant treaty provisions (which in fact proceeded from the premise that the model did not include any such solutions), so much so as to be rather polemical in certain respects, at the expense of the utility and credibility of the OECD model and commentary as interpretive tools.

It is certainly conceivable that the international community could eventually move toward (or perhaps back to) an alternative paradigm for international taxation, which could be premised on the lookthrough principle, but that has not yet occurred, at least not in principle. There is undoubtedly greater tax cooperation today in matters of taxation than ever before, but there is also greater tax competition than ever before. Europe is even trying to implement a common consolidated corporate tax base, and those efforts may eventually bear fruit, but at this time unresolved problems and disagreements remain. Nevertheless, most relevant countries are moving toward (or, like Canada, closer to) territoriality for the taxation of business income, such that we may eventually end up with a type of *de facto* lookthrough paradigm, cobbled together from a combination of corporate-level “participation exemptions” in respect of foreign-source income and the reduction or elimination of withholding taxes on distributions to non-residents. That type of approach might be more complex in certain respects, but it seems it would be more appropriate in the context of increasing globalization. Some of the complexity can be addressed through modern information technology. Moreover, that type of approach would

not necessarily have to be complicated, as demonstrated by Canada's much-maligned specified investment flowthrough trust (SIFT) rules—which, despite their political unpopularity, do seem to reflect a rational fiscal architecture more closely associated with the lookthrough principle, and to be more appropriate in the context of increasing globalization.<sup>166</sup>

It will always be good to revisit our premises and to reconsider our conclusions with respect to the policy and structural design elements of a functional international tax system, or a constellation of such systems. However, it will be important in that context to clearly identify our objectives and the compromises we deliberately make in relation to conflicting objectives. It is submitted that it is inappropriate to undercut such deliberate compromises through ex post facto rationalizations and what may be referred to as low-fidelity interpretations. Due process remains an important, higher-order value in free and democratic societies, governed by the rule of law, as opposed to managing the practicalities of herding cats, which must be how it feels at times for the OECD's Fiscal Committee (though that is the nature of its diplomatic mission).

It seems clear that the main *objective* to date has been the elimination of juridical double taxation. In that context, the *means* have consisted of credit-based undertakings, rate reductions, and exemptions, including measures reflecting deliberate or at least undeniably foreseeable double non-taxation. There have also been various efforts to address undesired non-taxation, but this objective has clearly taken a secondary place, with far less consensus around the particulars. It is submitted that this should not be surprising for two reasons. First, as noted above, the OECD model and commentary continue to reflect what are perceived to be substantial departures from what states continue to hold as a core sovereign interest, namely, the unfettered right to impose taxation. Second, as those involved in the early period of the development of the OECD model and commentary apparently had the good sense to understand, it is more important to eliminate double taxation than to address double non-taxation—for the simple reason that double taxation has the tendency to destroy incentive and wealth, whereas double non-taxation does not normally tend to destroy wealth, such that the system survives to tax another day.

This understanding is clearly reflected in the paragraphs of the Fiscal Committee's final report on the 1963 draft that were specifically emphasized by the OECD Council in the introduction to its ultimate recommendation adopting the 1963 draft and commentaries.<sup>167</sup> These were the following:<sup>168</sup>

- paragraph 5, emphasizing “increasing economic interdependence in the post-war period” and it being “necessary to revise prevailing practices for solving cases of double taxation”;

166 See the discussion in Nikolakakis, *supra* note 82.

167 OECD Council, *supra* note 94.

168 OECD Council, *supra* note 87.

- paragraph 48, emphasizing that the “process of extending and co-ordinating the double taxation Conventions between the Member countries is bound to be slow”;
- paragraph 51, emphasizing that the “first twenty-five articles . . . can provide effectual solutions to double taxation problems as they now stand,” and that this approach was gaining broader acceptance, even among countries that previously had no tax treaties;
- paragraph 53, emphasizing that “various questions remain to be examined and resolved”;
- paragraph 54, acknowledging the then recent commencement of “study [into] the question of the improper use of double taxation Conventions and of the fiscal evasion which can result from the interaction of the Conventions and the domestic laws,” among other ways in which the “solutions” that were provided in the first 25 articles may require “augmentation or refinement” in the future based on experience; and
- paragraphs 62 to 66, which focused on more procedural and institutional aspects of the work of the Fiscal Committee and of Council.

Emphasis was also placed on the draft commentary, which was focussed almost exclusively on the elimination of double taxation. It is submitted that this is a very good thumbnail sketch of the priorities of Council reflected in the drafting, and the adoption of, the OECD model and commentary. A deliberate compromise was struck early on, and fundamentally it has remained in place ever since.

To come full circle, we return to *Crown Forest*. It is submitted that proponents of the opposite view to the conclusion reached in this article often try to make much ado about nothing. With respect to the Supreme Court’s decision in *Crown Forest*, they refer to the following statement as if it were a condemnation of the type of treaty shopping that we are concerned with here (that is, through the use of holding companies, etc.):

But the shortcomings to the respondent’s interpretation go beyond the scenarios envisioned by the appellant. In fact, under the respondent’s interpretation, a foreign corporation whose place of management is in the U.S. would be a resident of the U.S. for purposes of the Convention notwithstanding that such a corporation may not have any effectively connected income to the U.S. and hence no U.S. tax liability at all. I find this possibility to be highly undesirable. “Treaty shopping” might be encouraged in which enterprises could route their income through particular states in order to avail themselves of benefits that were designed to be given only to residents of the contracting states. This result would be patently contrary to the basis on which Canada ceded its jurisdiction to tax as the source country, namely that the U.S. as the resident country would tax the income. On this point, see also Richard G. Tremblay, “Crown Forest—Tax Treaty Interpretation Bonanza” (1994), 4 Can. Curr. Tax C41.<sup>169</sup>

---

169 *Crown Forest*, supra note 2, at 5397.

To properly understand the significance of these comments, it is important to be clear about the hypothetical being posited.

Clearly, the court was referring to a situation in which there is “a foreign corporation whose place of management is in the U.S.” What the court was rejecting was an interpretation that would lead to the treatment of that foreign corporation as a “resident” of the United States. It is “this possibility” that the court found to be “highly undesirable.” The reference to “this possibility” was not a reference to the treaty shopping described in the following sentence, and while the court probably felt that such treaty shopping was also “highly undesirable,” it is important to be clear about exactly what it said in that following sentence. What “might be encouraged” if the court were to accept the taxpayer’s interpretation, and what would be “patently contrary to the basis on which Canada ceded its jurisdiction to tax as the source country,” was the result that such *foreign corporations* “could route their income through particular states in order to avail themselves of benefits that were designed to be given only to residents of the contracting states.” This comment makes perfect sense in the context of the hypothetical being considered by the court, namely, “a foreign corporation whose place of management is in the U.S.” The court quite properly concluded that extending treaty benefits under the US treaty to such foreign corporations would constitute improperly extending to them “benefits that were designed to be given only to *residents* of the contracting states [emphasis added],” and it is this result that the court quite properly characterized as “patently contrary to the basis on which Canada ceded its jurisdiction to tax as the source country.” That is the treaty interpretation “bonanza” referred to by Tremblay.

But this says *nothing* about the propriety of extending treaty benefits to actual “residents” of the contracting state—that is, of the propriety of extending treaty benefits under the US treaty to a “domestic corporation,” even if it is wholly owned by non-US persons. In that regard, it seems appropriate to point to the court’s comments in the following paragraph:

The respondent replies by submitting that it is the appellant’s interpretation of Article IV that would give rise to anomalous results. Most notably:

... if a United Kingdom corporation, the sole business of which for 50 years has been operating a Wyoming ranch, receives some passive income from Canada, it would not be considered a resident of the United States under the Appellant’s interpretation simply because of its historic place of incorporation, even though all of its economic connections are with the United States.

I find this scenario far less troubling than the one proposed by the appellants. In the above situation, *the mere incorporation of a company in the United States to which the passive income from Canada would flow would permit the taxpayer to benefit from the Convention.*<sup>170</sup>

Here, the court is specifically addressing the use of a US corporation wholly owned by a UK corporation benefiting from the US treaty in respect of “passive income

---

170 Ibid., at 5397-98 (emphasis added).

from Canada.” The court is certainly not condemning that practice in this context. On the contrary, what the court seems to be saying is that there can be significant differences between the treaty consequences that flow from different legal structures that may have identical economic profiles (because that is exactly the hypothetical being considered in this paragraph), including differences that can arise because of “the mere incorporation of a company.”

Moreover, although it is true that in the hypothetical considered in the paragraph above, the Canadian-source income would likely be taxable in the hands of a “domestic corporation,” the premise of the hypothetical is already that the income is “effectively connected income,” so that “the mere incorporation of a company” would have as its intended result only a change in the Canadian tax consequences that flow from the US treaty. When you think about it, that would probably be an avoidance transaction under GAAR, but this decision of the Supreme Court hardly stands as an authority that any abuse should be considered to result in such a hypothetical.

In addition, it is submitted that there is even further evidence that the court was more indifferent than indignant toward the factual presence of US non-taxation in the circumstances of the facts before it, just as it was indifferent to the factual presence of taxation in the hypothetical considered in the paragraph above. In this regard, reference may be made to the following comments:

In the case at bar, I underscore that there is no need to prevent double taxation because the U.S. has declined to tax Norsk’s revenue. Although this does not affect Norsk’s tax liability, the effect is still that Norsk is not required to pay any tax in the United States by virtue of the s. 883(a) exemption, this exemption arising by virtue of a reciprocal arrangement between the U.S. and the Bahamas, where Norsk is incorporated. Further, it is unclear whether the specific rental income at issue is even, independent of the exemption, subject to taxation in the U.S. because, pursuant to s. 864(c)(4) of the Internal Revenue Code, it might not be considered to be effectively connected with the conduct of Norsk’s American trade or business. Allowing Norsk to benefit from the Convention in this case would actually lead to the avoidance of tax on the rental income because the liability for tax asserted by the Canadian authorities would be reduced notwithstanding that the United States chooses not to impose any tax thereon or does not even have the jurisdiction therefor.<sup>171</sup>

It is clear that the court did not feel it appropriate to encourage foreign corporations routing income through treaty-country “branches” that are not fiscally visible to the treaty country, but it also clear that the court held that the presence of this non-taxation “does not affect Norsk’s tax liability,” which was the specific question of interpretation before the court. Thus, the court was analytically indifferent toward the presence of non-taxation, if somewhat concerned from a policy perspective. But what is important in the context of a legal determination is the analytical significance of a particular factor, not whether it provides grounds for concern from a policy

---

171 Ibid., at 5397.

perspective. Policy is part of the analytical exercise, but only part of it, and having grounds for concern is not the same as having a demonstrable abuse.

One final point should be noted on “much ado about nothing.” Reference is also often made to paragraph 7 of article XXIX A of the US treaty (the LOB article), and the related portions of the technical explanation, which, in general terms, acknowledge that the contracting states intend to preserve the application of their respective anti-avoidance rules and principles. But what exactly do they say?

Article XXIX A(7), as amended by the fifth protocol (2007), reads as follows:

7. It is understood that this Article *shall not be construed as restricting* in any manner the right of a Contracting State to deny benefits under this Convention where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of this Convention [emphasis added].

This provision does not constitute a sword; rather, it is a shield against an a contrario inference being drawn to the effect that the insertion of the LOB article was intended to *restrict* the application of domestic anti-avoidance rules and principles aimed at abuse. To interpret this shield as a sword—and to infer from it an intention to provide for the application of an inherent anti-abuse rule—is as improper logically as to infer a purpose against double non-taxation from the presence of a purpose of eliminating double taxation. It is also interesting that paragraph 6 of article XXIX A provides for an administrative override, but only to allow benefits, not to deny them—once again, no separate sword.

The technical explanation from the fifth protocol (which made the LOB reciprocal) says this:

New paragraph 7 is in substance similar to paragraph 7 of Article XXIX A of the existing Convention and clarifies the application of general anti-abuse provisions. New paragraph 7 provides that paragraphs 1 through 6 of Article XXIX A shall not be construed as limiting in any manner the right of a Contracting State 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. This provision permits a Contracting State to rely on general anti-avoidance rules to counter arrangements involving treaty shopping through the other Contracting State.

Thus, *Canada may apply its domestic law rules* to counter abusive arrangements involving “treaty shopping” through the United States, and the United States may apply its substance-over-form and anti-conduit rules, for example, in relation to Canadian residents. This principle is recognized by the OECD in the Commentaries to its Model Tax Convention on Income and on Capital, and the United States and Canada agree that it is inherent in the Convention. The statement of this principle explicitly in the Protocol is not intended to suggest that the principle is not also inherent in other tax conventions concluded by the United States or Canada.<sup>172</sup>

172 United States, Department of the Treasury, Technical Explanation of the Protocol done at Chelsea on September 21, 2007, amending the Convention between the United States of America and Canada with respect to taxes on income and on capital done at Washington on September 26, 1980, released by the Department of the Treasury July 2008 (emphasis added).

The language is similar to that in the technical explanation for the third protocol (1995), which introduced the LOB article (and was quoted by Bowman J in *RMM Canadian*):<sup>173</sup>

General anti-abuse provisions—Paragraph 7 was added at Canada’s request to confirm that the specific provisions of Article XXIX A and the fact that these provisions apply only for the purposes of the application of the Convention by the United States should not be construed so as to *limit* the right of each Contracting State to invoke applicable *anti-abuse rules*. Thus, for example, Canada *remains free* to apply *such rules* to counter abusive arrangements involving “treaty-shopping” through the United States, and the United States remains free to apply its substance-over-form and anti-conduit rules, for example, in relation to Canadian residents. This principle is recognized by the Organization for Economic Cooperation and Development in the Commentaries to its Model Tax Convention on Income and on Capital, and the United States and Canada agree that it is inherent in the Convention. The agreement to state this principle explicitly in the Protocol is not intended to suggest that the principle is not also inherent in other tax conventions, including the current Convention with Canada.<sup>174</sup>

This language, in both versions, contemplates only the application of domestic anti-abuse provisions. It is the preservation of that “right” (which is the thing described as being “inherent”) that this provision speaks to, not the creation of some separate inherent anti-abuse rule within the four corners of the US treaty. But that says nothing more than what Bowman J said in *RMM Canadian*.

As for whether or not this technical explanation is consistent with the OECD commentary, what is odd is that the technical explanation refers to treaty shopping, and the LOB article in the US treaty was introduced before the 2003 revisions to the commentary. That is, the 1995 technical explanation was written in a context where the 1992 revisions to the commentary focused on base company situations, and the OECD’s own report on conduit companies said that treaty benefits had to be granted even in cases of improper use—subject, of course, to beneficial ownership considerations and any other specific treaty provisions, as well as to the usual definitional and characterization considerations (including under deeming rules).<sup>175</sup> By the time of the fifth protocol, and by virtue of the 2003 revisions, the commentary had caught up to the third protocol; but that still does not take the matter beyond the application of domestic anti-abuse rules, nor does it justify the application of those rules. That is, the fact that it is acknowledged in a treaty that the treaty does not preclude the application of domestic anti-abuse rules does not establish that the conditions for the application of those rules have been satisfied. Moreover, although

173 See supra note 25 and the accompanying text.

174 United States, Department of the Treasury, Technical Explanation of the 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, signed at Washington, DC on March 17, 1995.

175 See OECD Committee on Fiscal Affairs, supra note 54, at paragraph 43.

the fact that the 1995 technical explanation refers to treaty shopping (as an example of the type of situation that may be affected by domestic anti-abuse rules) would be relevant in the context of a unified textual, contextual, and purposive interpretation and application of the US treaty and of GAAR, the significance of this must be understood in the context of the observation that the US treaty now contains a reciprocal LOB article, such that it should be surprising from a Canadian perspective for a treaty-shopping case to engage the application of GAAR, except with respect to circumstances in which the facts would likely involve some sort of effort to manipulate or circumvent the threshold tests and other conditions applicable under the LOB article. There may be circumstances where such efforts would result in an abuse, but there are also circumstances in which manipulation of the facts would not give rise to an abuse—for example, efforts to achieve “qualifying person” status in order to permit a US domestic corporation to enjoy a treaty benefit under the US treaty on capital gains from the disposition of taxable Canadian property, equivalent to the treaty benefit that either the US corporation’s non-US parent would get if it had held and disposed of the property directly, or that the US corporation would get if whoever had drafted the “derivative benefits” clause in article XXIX A(4) had thought about capital gains.

As for what this says about the presence or scope of an inherent anti-abuse rule (or even the preservation of the “right” to apply domestic anti-abuse rules) in other Canadian treaties, the answer must be “nothing.” Canada cannot speak for the other contracting states—certainly not by agreeing to the addition of a particular provision of the US treaty, or by assenting to a particular interpretation of that provision written by the US Treasury. That is just not the rule of law, and it is not the way our system works. But the drafters should be taken to have known this, from which it follows that the technical interpretation is nothing more than yet another shield—this one being a shield against a shield—in the sense that the drafters did not want an *contrario* interpretation to arise in the collateral context of the other treaties as a result of the introduction of the LOB article in the US treaty. That is fine. But to infer from this the presence of some separate inherent anti-abuse rule in all of Canada’s treaties (or even in the US treaty) would be to make a right out of two wrongs—even worse than much ado about nothing, it would be an unthinkable anathema!

Finally, as for the intentions of other contracting states, does anybody really think that when the Netherlands enters into a tax treaty, it intends to restrict its application to entities owned by Dutch residents, or to impose any significant amount of tax on the foreign earnings of such entities or on their distributions? (Not that there is anything “improper” about that.) That is not even the systemic expectation of LOB articles, given their derivative benefits provisions, and given that they permit minority position “leakage.” So here’s a question. Assume that a US domestic corporation is owned as to 100 percent by US individuals, and that it carries on a taxable US business. Assume that it has a Canadian subsidiary, as well as substantial other foreign subsidiaries. What if the US corporation has 100 of equity and has borrowed 200 from a combination of US and third-country lenders, in proportions designed to ensure that it meets the base erosion test under article XXIX A2(e) with a maximum

permissible amount of third-country debt, and also then capitalizes the Canadian corporation with debt as to a ratio of 2:1? The US corporation would pass the technical test and would qualify for treaty benefits on interest paid by the Canadian corporation, subject to GAAR. Could there be a finding of abuse in such a case on the theory that the LOB article or the US treaty generally reflects an inherent systemic expectation that treaty benefits are to be enjoyed only for income that is in fact taxed in the United States, and not for income that is eroded out to third-country residents? It is submitted that there is no basis for that conclusion under the US treaty. But where one gets to on the full spectrum of possibilities is anybody's guess.

