Tax Treaty Abuse: A Second Look

Nathalie Goyette*

ABSTRACT

In this age of globalization, international trade and transactions continue to increase, and the role of tax treaties appears more significant today than ever before. In this context, the question whether domestic anti-abuse rules can be applied to counter abuse of tax treaties is highly relevant. This article examines this problem from a Canadian perspective. First, the author considers whether Canadian law recognizes that a general anti-abuse rule can be applied to treaties. She then addresses the general anti-avoidance rule found in section 245 of the Income Tax Act. After examining whether the wording of the rule is broad enough to encompass treaty abuse, the author devotes a substantial part of the article to the question of consistency between the general anti-avoidance rule and Canadian tax treaties. In answer to that question, two traditional approaches—the "transactional" and the "interpretive"—are examined. From this examination emerges a third approach, concordant interpretation, which the author advocates as the best method for solving the issue of consistency between the general anti-avoidance rule and Canadian tax treaties.

KEYWORDS: ABUSES ■ AVOIDANCE ■ GAAR ■ TAX TREATIES ■ INTERNATIONAL TAXATION

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* Lawyer, Canada Department of Justice. In this capacity, I represent the minister of national revenue before the courts. The opinions expressed in this article are my own and in no way represent the position of the Canada Customs and Revenue Agency or the Department of Justice. I am grateful to David Spiro and Brian Arnold for their helpful suggestions and review of the text. I would also like to thank Thomas Schäefer and Marc Lampe for their valuable assistance in writing the part of the article that deals with the German law. Finally, special thanks are extended to Susan Shaughnessy and Daniel Verdon.

INTRODUCTION

In 1999, the Canadian Tax Foundation published my master's thesis entitled *Countering Tax Treaty Abuses: A Canadian Perspective on an International Issue*[1] (referred to in this article as "the 1999 thesis"). In the 1999 thesis, I considered whether a general anti-abuse rule existed that the Canadian government could use to deal with abusive transactions involving Canadian tax treaties, and I examined the interaction between the general anti-avoidance rule[2] (GAAR) and Canada's tax treaties. This article takes another look at these issues. Specifically, I will examine whether developments in the literature, the jurisprudence, and the position of the Organisation for Economic Co-operation and Development (OECD) lead to conclusions different from those reached in 1999.

GENERAL ANTI-ABUSE RULE

In the Canadian context, reference to abusive transactions generally directs attention to GAAR, contained in section 245 of the ITA. For this reason, and because the government had recourse to GAAR in *RMM Canadian Enterprises Inc. et al. v. The Queen*[3] (the only Canadian case dealing with treaty abuse), a significant portion of the 1999 thesis was devoted to the interaction between GAAR and tax treaties. However, the authors who have recently examined the issue of treaty abuse seem to agree that the chances for success by the Canadian tax authorities with respect to treaty abuse lie in the use of a general anti-abuse rule applicable to treaties rather than in recourse to GAAR.[4] It is therefore necessary to re-examine the issue of the existence of a general anti-abuse rule that would apply in cases of treaty abuse. In 1999, the following four elements were examined in order to determine whether or not there existed a general anti-abuse rule: the preamble of treaties, article 26 of the Vienna

1 Nathalie Goyette, *Countering Tax Treaty Abuses: A Canadian Perspective on an International Issue*, The Tax Professional Series (Toronto: Canadian Tax Foundation, 1999).

2 Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA"). Unless otherwise stated, statutory references in this article are to the ITA.

3 97 DTC 302 (TCC).

4 James R. Wilson and Jillian M. Welch, "The GAAR and Canada's Tax Treaties: Which Is Trump?" in Brian Arnold and Jacques Sasseville, eds., *Special Seminar on Canadian Tax Treaties: Policy and Practice* (Kingston, ON: International Fiscal Association, Canadian Branch, 2001), 6:1-72, at 6:15-22, 6:52-69, and 6:71; and Deborah Toaze, "Tax Sparing: Good Intentions, Unintended Results" (2001) vol. 49, no. 4 *Canadian Tax Journal* 879-924, at 909-14.

convention,[5] an international principle, and the decision of the Supreme Court of Canada in *Crown Forest Industries v. Canada*.[6]

Preamble to Treaties

The 1999 thesis concluded that the preamble to Canadian treaties, which stipulates that the purpose of the treaty is to prevent tax evasion, does not constitute a general anti-abuse rule applicable to treaties for three reasons. First, tax evasion is not synonymous with tax avoidance, and in cases of abuse, the issue is avoidance. Second, although the preamble refers to the prevention of tax evasion, treaties generally do not include provisions to deal with evasion. Finally, the "domestic tax benefit provision" contained in most Canadian tax treaties (according to which the provisions of the treaty do not restrict in any way the deductions, credits, exemptions, exclusions, or other allowances available under domestic tax law), coupled with the principle that treaties do not levy taxes, supports the argument that the preamble to treaties does not include a general anti-abuse rule.[7]

There have been no recent developments that would qualify the conclusion described in the preceding paragraph, although one factor deserves mention: the preamble to the convention between Canada and Venezuela,[8] signed in 2001 and soon to come into force. The English version of the preamble refers to the "prevention of fiscal avoidance and evasion." An official from Canada's Department of Finance has indicated that this wording was included at the specific request of Venezuela in order to indicate its intention to attack avoidance transactions. It is not surprising that the word "avoidance" was inserted at Venezuela's request since the usual Canadian practice is that the preamble to a treaty refers only to the prevention of tax evasion. Curiously, the French version of the preamble of the Canada-Venezuela treaty refers to the prevention of "l'évasion et la fraude fiscales" (tax evasion and fraud) and makes no mention of avoidance. The Spanish version also refers to "evasión y el fraude fiscal."

At first glance, it is difficult to find a common meaning in the three versions[9] that would support the assertion that the treaty seeks to prevent tax avoidance, because

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5 Vienna Convention on the Law of Treaties, UN Doc. A/Conf. 39/27, signed at Vienna on May 23, 1969, entered into force January 27, 1980 (herein referred to as "the Vienna convention").

6 [1995] 2 SCR 802.

7 Goyette, supra note 1, at 7-10.

8 Convention Between the Government of Canada and the Government of the Bolivarian Republic of Venezuela for the Avoidance of Double Taxation and the Prevention of Fiscal Avoidance and Evasion with Respect to Taxes on Income and on Capital, signed in Caracas on July 10, 2001 (herein referred to as "the Canada-Venezuela treaty").

9 Under article 33(3) of the Vienna convention, the terms of a treaty are presumed to have the same meaning in the various linguistic versions of the text, and article 33(4) prescribes an interpretation that reconciles the different versions of the text of a treaty. The necessity of searching for the shared meaning between the two versions of a bilingual text was reiterated by the Federal Court of Appeal in *Hogg v. The Queen et al.*, 2002 DTC 7037, at 7040 (FCA).

the Spanish word "evasión" can be translated as either "evasion"[10] or "avoidance."[11] Consequently, it is difficult to speculate on the weight that would be given to the preamble to the Canada-Venezuela treaty in the context of abusive transactions. However, on the basis of the case law,[12] as well as paragraphs 1 and 2 of article 31 of the Vienna convention, according to which a treaty is to be interpreted taking into account its context, which includes the preamble, it can be stated that a court called upon to rule on a transaction abusing the Canada-Venezuela treaty would examine the preamble. Also, if the government of Venezuela testified that its intention was that which is indicated in the English version of the preamble and the Canadian government confirmed that this was indeed the intention of the parties, or if the documentation prepared during the negotiation process[13] confirmed a mutual intention to counter tax avoidance, the preamble could influence a court in ruling on

10 For example, the title of the tax treaty between France and Spain reads in French as Convention entre la République Française et le Royaume d'Espagne en vue d'éviter les doubles impositions et de prévenir *l'évasion et la fraude fiscales* [tax evasion and fraud] en matière d'impôts sur le revenu et sur la fortune (emphasis added), while the Spanish title reads as Convenio entre el Reino de España y la República Francesa a fin de evitar la doble imposición y prevenir la *evasión y el fraude fiscal* en materia de Impuestos sobre la Renta y sobre el Patrimonio (emphasis added). See also the *Larousse français-espagnol* by Ramón García-Pelyo and Jean Testas, under "*évasion*."

11 According to a search conducted in the databank "TERMIUM Plus," a databank developed by Canada's Department of Public Works and Government Services.

12 In the following three cases, the Federal Court of Appeal interpreted the tax treaty between Canada and the United States in light of its preamble: *Utah Mines Ltd. v. The Queen*, 92 DTC 6194, at 6196 (FCA); *Coblentz v. The Queen*, 96 DTC 6531, at 6534 (FCA); and *Dudney v. R*, [2000] 2 CTC 56, at 60 (FCA); leave to appeal to the Supreme Court of Canada denied (2002), 264 NR 394. In *Dudney*, the Federal Court was asked to rule on the meaning of the expression "has . . . a fixed base regularly available to him" within the meaning of article XIV of the Canada-US treaty (The Convention Between Canada and the United States of America with Respect to Taxes on Income and 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, and July 29, 1997) (herein referred to as "the Canada-US treaty"). The court noted that it was required to apply the meaning that the contracting states had intended to give the expression and that it must avoid a literal or legalistic interpretation. The Court of Appeal nonetheless limited its investigation of the parties' intention to the text of the preamble of the treaty. The preamble stipulates that the contracting states wished to enter into an agreement for the avoidance of double taxation and the prevention of tax evasion. Since the *Dudney* case involved neither evasion nor double taxation, the court did not examine the preamble in greater depth. It is suggested here that the court could have subjected the preamble to closer scrutiny since, in my view, article XIV allocates the taxing powers between the contracting states, and this may be the only case in which a treaty addresses the issue of preventing double taxation. As argued in the 1999 thesis (supra note 1, at 8-9), it seems that in other cases it is domestic law, rather than the treaties, that has provided a remedy against double taxation. Concerning the argument that the allocation of taxing powers between the contracting states constitutes a means of preventing double taxation, see Brian J. Arnold, Jacques Sasseville, and Eric Zolt, "Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century," Symposium (2002) vol. 50, no. 1 *Canadian Tax Journal* 65-144, at 96.

13 These are supplementary means of interpretation within the meaning of article 32 of the Vienna convention. On this point, see Goyette, supra note 1, at 64-65.

a transaction that constituted an abuse of the treaty. For example, the preamble could lead a court to conclude that there is no inconsistency between GAAR and the treaty. However, for the following reasons, it does not seem possible to argue that the preamble, even with the wording used in the treaty with Venezuela, in itself constitutes a general anti-abuse rule: first, treaties do not generally include a provision to counter avoidance; second, treaties do include a domestic tax benefit provision; and third, treaties do not levy taxes.

Article 26 of the Vienna Convention

The fundamental principle of treaty law, *pacta sunt servanda*, is set out in article 26 of the Vienna convention, which provides, "Every treaty in force is binding upon the parties to it and must be performed by them in good faith." In light of the principle that states must execute a treaty in good faith, it is legitimate to doubt that the residents of those states are entitled to abuse the treaty in question. In this regard, it is important to recall that in international law, residents have rights that states confer on them and the rights conferred on residents cannot override the rights of the parties to the treaty.[14] The issue of whether a state can attack a transaction that constitutes an abuse of one of its treaties by invoking article 26 was addressed in the 1999 thesis, and it was concluded that the OECD commentary regarding article 26 greatly weakens the chances for success of an attack based on that provision. In a 1987 report, the OECD's Committee on Fiscal Affairs in fact affirmed that the *pacta sunt servanda* rule implies that in the absence of a specific anti-abuse provision in a treaty, the benefit provided for under the treaty must be granted, even if it is considered unjustified.[15] Moreover, in a subsequent report, the same committee stated that the expression "must be performed . . . in good faith" means that states are bound under international law to apply the provisions of their treaties and that the terms and conditions of application are matters to be decided by each state.[16] In the 1999 thesis, I argued that these comments could be interpreted as requiring that states respect the letter of a treaty but not necessarily its purpose. Yet, in transactions that are abusive of treaties, it is often the purpose of the treaty that is frustrated.[17]

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14 Regarding the issue of the rights of citizens in public international law, see J.-Maurice Arbour, *Droit international public*, 4th ed. (Cowansville, QC: Yvon Blais, 2002), 2-4; and Vaughan Lowe in International Fiscal Association, *How Domestic Anti-Avoidance Rules Affect Double Taxation Conventions*, proceedings of a seminar held in Toronto in 1994 during the 48th Congress of the International Fiscal Association, vol. 19c (The Hague: Kluwer Law International, 1995), 8.

15 Organisation for Economic Co-operation and Development, *International Tax Avoidance and Evasion: Four Related Studies*, Issues in International Taxation no. 1 (Paris: OECD, 1987), 101.

16 Organisation for Economic Co-operation and Development, *Tax Treaty Override* (Paris: OECD, 1989), paragraph 10.

17 Goyette, supra note 1, at 10-12.

Recent changes to the commentary on article 1 of the OECD model tax convention[18] certainly make it possible to set aside the previous assertion of the Committee on Fiscal Affairs that the *pacta sunt servanda* rule means that anti-abuse measures must be included in treaties, failing which the benefit of the treaty must be granted. The new commentary provides that states can have recourse to domestic anti-abuse rules in order to counter an abuse of a treaty and that, generally, there will be no conflict between such domestic anti-abuse rules and tax treaties.[19] With regard to the committee's 1989 comments that seemed to restrict the obligation of states to execute treaties in good faith to respect for the letter of the treaty, it must be first recalled that in addition to article 26, another provision of the Vienna convention invokes the notion of good faith: article 31 requires in effect that a treaty be interpreted in good faith. New paragraph 9.3 of the commentary on article 1 of the model convention[20] indicates that for some states, it is on account of the obligation to interpret treaties in good faith, as well as the object and purpose of treaties, that one can conclude that domestic anti-abuse measures are consistent with treaties. Also, new paragraph 9.5 of the commentary on article 1 recommends that the object and purpose of a particular treaty provision should be taken into account in order to determine whether a transaction is an abuse of that provision. Paragraphs 9.3 and 9.5 of the commentary evidence a desire to go beyond the mere letter of treaties and to consider their object and purpose. It therefore seems reasonable to suggest that the 1989 comments of the Committee on Fiscal Affairs, if they seemed to restrict the scope of article 26 of the Vienna convention to respect for the letter of treaties, have been superseded or at least must be qualified by the new commentary on article 1 of the model convention. As a consequence, the weaknesses identified in the 1999 thesis regarding an attack of transactions abusive of treaties based on article 26 of the Vienna convention no longer exist in 2003.

Principle of International Law

Article 38(1)(c) of the United Nations Statute of the International Court of Justice[21] states that "the general principles of law recognized by civilized nations" are a source of international law. According to some commentators, given that the concept of abuse of rights exists in some sense in most countries and that it is internationally recognized, both by international courts and by the practice of states, this concept meets the requirements of article 38(1)(c). It should therefore

18 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital*, condensed version (Paris: OECD, January 2003) (herein referred to as "the model convention").

19 See paragraphs 9.1 to 9.5, 22.1, and 22.2 of the commentary on article 1 of the model convention, ibid.

20 This provision discusses one of the two approaches adopted by states to conclude that there is no conflict between domestic anti-abuse provisions and tax treaties.

21 Available on the Web at http://www.un.org/Overview/Statute/contents.html.

be recognized and applied by the tax authorities that implement tax treaties and by the courts that interpret them.[22] The 1999 thesis discussed two difficulties that should overcome a denial of the benefits of a treaty based on the international principle of abuse of rights.

The first difficulty was the undefined scope of the principle. As the existence of this international principle has not yet been recognized by the courts in the area of taxation, no criteria have been articulated by which it may be determined whether a particular transaction is abusive of a treaty. By contrast, in the context of Canadian domestic law—that is, in cases of abuse of the ITA—paragraph 245(4) and decisions of the courts on the issue have led to the formulation of two criteria for determining what constitutes an abusive transaction. According to these criteria, a transaction is abusive (1) when it constitutes a misuse of one or more provisions of the ITA leading to a result contrary to the statutory scheme or underlying policy of a provision of the ITA or of the ITA as a whole; or, more simply, (2) when the result of the transaction is contrary to the statutory scheme or underlying policy of a provision of the ITA or of the ITA as a whole.[23] Can similar criteria be used in the context of treaty abuse? If so, what are the policies that underlie Canada's tax treaties? In other words, what is the spirit of tax treaties? While it is readily agreed that the object of tax treaties is the elimination of double taxation and the equitable allocation of taxing powers between contracting states, a deeper analysis often proves necessary when the task is to determine the underlying policy of certain treaty provisions. Some would argue that, since the taxpayer is not a party to the treaty, he is less likely, and does not have the resources, to accurately determine the underlying purposes of the treaty.[24] It could be argued in rebuttal that the taxpayer is not a party to the ITA either but is nonetheless expected to comply with not only the letter but also the spirit of the ITA.[25] Furthermore, as is the case in matters of abuse of domestic law

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22 Goyette, supra note 1, at 12-13. See also the decision of the Supreme Administrative Court of Finland in *A Oyj Abp*, March 20, 2002, KHO:2002:26, an unofficial translation of which is reported in (2002) 4 *International Tax Law Reports* 1043. In that case, the court relied on the commentary on the model convention, according to which the majority of OECD member countries consider "subsection F"-type provisions (legislation that taxes the income of a low-taxed foreign affiliate in the hands of its domestic shareholder) to be compatible with tax treaties, and concluded that there existed an international principle to that effect. See ibid., at 1070. On the merits of that aspect of the decision by the Supreme Administrative Court of Finland, see Michael Lang, "CFC Regulations and Double Taxation Treaties" (2003) vol. 57, no. 2 *Bulletin for International Fiscal Documentation* 51-58, at 51-52.

23 *OSFC Holdings Ltd. v. Canada*, [2002] 2 FC 288, at 318-20; leave to appeal to the Supreme Court of Canada denied, document no. 28860; and *Mathew et al. v. The Queen*, 2002 DTC 1637, at 1690 (TCC); appeal filed to the Federal Court of Appeal, docket no. A-349-02.

24 Stef van Weeghel, *The Improper Use of Tax Treaties, with Particular Reference to the Netherlands and the United States*, Series on International Taxation no. 19 (The Hague: Kluwer Law International, 1998), 100.

25 On this subject, see the decision in *Water's Edge Village Estates (Phase II) Ltd. v. The Queen*, 2002 DTC 7172 (FCA); leave to appeal to the Supreme Court of Canada denied, document no. 29392, March 20, 2003. In this case, the Federal Court of Appeal conducted an exhaustive analysis of

(that is, abuse of the ITA), it is always possible to have recourse to extrinsic material in order to perform an in-depth analysis and thus determine the underlying policy of a treaty or of one of its provisions.[26] The determination of the underlying policies of tax treaties is, accordingly, an achievable objective, even though the task may, on occasion, prove demanding.

For the reasons indicated above, in my view criteria similar to those used in Canadian domestic law to determine whether there is an abuse of the ITA—that is, criteria that require an analysis of the policy underlying the ITA as a whole and each of its provisions—could become the criteria of an international anti-treaty-abuse principle. The adoption of these criteria, as well as the adoption of different criteria as long as they serve to identify what constitutes an abusive transaction, would eliminate the first weakness noted in 1999 with respect to an argument based on an international anti-treaty-abuse principle.

The other major difficulty with the international anti-abuse principle noted in 1999 stems from the first difficulty, to which are added the limits of Canadian tax law on abuse. At issue is the threshold that must be met for an international anti-abuse principle to be applied. A court will agree to apply an international anti-abuse principle if it is satisfied that this principle is recognized universally, or at least by a large number of countries. It then follows that the standard of anti-abuse applied will likely be the lowest common denominator for all anti-abuse principles in the countries concerned.[27] If, for example, the doctrine of substance over form is to be applied as an international anti-abuse principle recognized by civilized nations, the limits of this principle will need to be taken into account not only in other countries but also, and especially, in Canadian law. In fact, it will be necessary to contend with decisions of the Supreme Court of Canada that have virtually eliminated this principle of Canadian law, and with the fact that recent Supreme Court rulings on

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the capital cost allowance system under the ITA and concluded that the outcome of the transactions carried out by the taxpayer was in keeping with the letter but not the spirit of the ITA. The court thus upheld the application of GAAR to the transactions in question. See ibid., at 7178-80.

26 *OSFC Holdings*, supra note 23, at 319-20; *Jabin Investments Ltd. v. The Queen*, 2001 DTC 1002, at 1011-12 (TCC); aff'd. 2003 DTC 5027 (FCA); and *RMM Canadian Enterprises*, supra note 3, at 315.

27 Klaus Vogel and Stef van Weeghel recommend the establishment of a high threshold for the application of an international anti-abuse principle for treaties: Klaus Vogel et al., *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation of Income and Capital, with Reference to German Treaty Practice*, 3d ed. (London: Kluwer Law International, 1997), 124-25; and van Weeghel, supra note 24, at 100-1. Van Weeghel justifies this recommendation as follows. First, since the taxpayer is not a party to the treaty, he is less likely, and does not have the resources, to accurately determine the underlying aims of the treaty. Second, one of the major aims of the treaty is the allocation of taxing powers. The imbalance in advantages that results from abuse by a taxpayer is not as significant as the imbalance that results from a state's actions. Third, when taxpayers are involved, it is a national court that determines whether or not there is abuse. Unfortunately, that national court has limited knowledge and powers with respect to the tax system of the other contracting state.

the subject of avoidance give no indication that the court intends to adopt a different attitude in this regard.[28]

That said, it is important not to underestimate the cumulative effect of lower court decisions, particularly those of the Tax Court of Canada, which hears far more tax cases than the Supreme Court of Canada. Of course, the Tax Court of Canada is bound by the decisions of the Supreme Court, and a judge of the Tax Court cannot be expected to challenge a Supreme Court ruling. However, a judge of the Tax Court of Canada who is thoroughly acquainted with the facts of a case, and who draws his conclusions from those facts, may, when confronted with an avoidance transaction that seems to him abusive in the ordinary meaning of the term, be tempted to distinguish the facts from those of a decision of the highest court in the country in order to invalidate the transaction in question. Moreover, one can discern in recent jurisprudence of the lower courts a tendency to apply a doctrine of substance over form by which the court can determine the true legal nature of a transaction, not as a function of its legal structure or the name it has been given, but according to the rights and obligations it creates—in other words, according to its legal consequences.[29] Of course, because of the position adopted by the Supreme Court with regard to substance over form, it is very likely that a decision by the Tax Court of Canada invalidating a transaction that was an abuse of a tax treaty on the basis of the international principle of substance over form would be appealed. Can one seriously believe, in light of its rulings on this question, that the Supreme Court would uphold lower courts that applied the doctrine of substance over form? There are two factors that could encourage the Supreme Court to uphold a ruling by a lower court that endorsed the doctrine of substance over form in a case of treaty abuse. The first factor would be a resurrection of the doctrine based on the dissenting reasons of LeBel J in *Singleton*.[30] In his dissenting opinion, LeBel J argued that the decision of McLachlin J in *Shell*[31] does not constitute repudiation

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28 Goyette, supra note 1, at 12-15. On this point, see also Wilson and Welch, supra note 4, at 6:41; Brian J. Arnold, "Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance" (2001) vol. 49, no. 1 *Canadian Tax Journal* 1-39, at 15-22; and Brian J. Arnold, "Canada's Supreme Court Decides 'Reasonable Expectation of Profit' Cases" (July 1, 2002) vol. 27, no. 1 *Tax Notes International* 111-17.

29 See the following rulings: *Kenmont Management Inc. v. Saint John Port Authority* (2002), 248 NBR (2d) 1, at 19 (CA); *QEW 427 Dodge Chrysler (1991) Inc. v. Ontario* (2000), 49 OR (3d) 776, at 792-93, 795-96 (SC); *Hurd v. R*, [2001] 2 CTC 2489, at 2491 (TCC); *Witkin v. R*, [2002] 3 CTC 184, at 187-88 (FCA); and *Foresbec et al. v. The Queen*, 2002 DTC 1786, at 1795 (TCC), where the court, although it uses the term "sham," seems in fact to use the doctrine of substance over form. The decision was upheld by the Federal Court of Appeal: 2002 DTC 7041 (Fr.). There are, however, a number of recent rulings that have given precedence to respect for the legal form of a transaction. In this regard, see, for example, *General Motors Acceptance Corp. of Canada v. R*, [2000] 2 CTC 2061, at 2078-79 (TCC); *Sussex Square Apartments Ltd. v. R*, [2000] 4 CTC 203, at 204 (FCA); and *Hill v. The Queen*, 2002 DTC 1749, at 1760-61 (TCC).

30 *Singleton v. Canada*, [2001] 2 SCR 1046.

31 *Shell Canada Ltd. v. Canada*, [1999] 3 SCR 622.

by the Supreme Court of the principle that the economic realities (the substance) of transactions must be taken into account. LeBel J considered instead that the ruling in *Shell* simply provided two points of clarification concerning this principle.[32] The second factor that could encourage the Supreme Court to uphold a lower court ruling supporting the doctrine of substance over form in a treaty abuse case would be the approach initiated by the Supreme Court in *Crown Forest* with regard to the interpretation of treaties.

The Crown Forest Decision

In *Crown Forest*, the Supreme Court of Canada was asked to determine whether a corporation incorporated in the Bahamas, Norsk, was resident in the United States for the purposes of the application of the Canada-US treaty.[33] If such were the case, Norsk could benefit from a reduced rate of withholding tax in respect of rental income that it earned in Canada. Iacobucci J made the following comments in the course of his analysis:

> 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.[34]

Iacobucci J went on to state that adopting the interpretation of the word "resident" proposed by Norsk would mean that a corporation that was not subject to any US tax could nonetheless benefit from the reduction in Canadian withholding tax provided for in the Canada-US treaty. This observation led him to comment:

> "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.[35]

One of the conclusions of the 1999 thesis was that the interpretive presumption against treaty shopping that emerges from the above extract could constitute an effective weapon for the Canadian government. However, it was recommended that

32 *Singleton*, supra note 30, at 1065-69. McArthur J's comments in *Dobbin v. The Queen*, 1999-2737(IT)G, at paragraph 24, are to the same effect. However, the comments of Major J in *Will-Kare Paving & Contracting Ltd. v. R*, [2000] 3 CTC 463, at 482 (SCC), could be interpreted as being entirely opposite to those of LeBel J in *Singleton*.

33 Canada-US treaty, supra note 12.

34 Supra note 6, at 825.

35 Ibid., at 826.

this presumption be applied so as to respect the concordance or symmetry of treatment reserved by contracting states in respect of a transaction.[36] This conclusion remains unchanged today.

Indeed, the numerous other decisions that have referred to the modern and broad interpretive rule for treaties proposed by the Supreme Court in *Crown Forest* seem to confirm that the latter judgment has had a distinct impact on the manner in which the courts approach Canadian tax treaties.[37] It is true that to date no lower court has been called upon to rule on the application of the presumption against treaty shopping; however, it should be remembered that in *RMM Canadian Enterprises*, Bowman J had recourse to a rule of interpretation similar to the anti-treaty-shopping rule set out in *Crown Forest*.[38] Moreover, recent literature indicates that the presumption against treaty shopping articulated in *Crown Forest* may be a more useful weapon for Canadian tax authorities than GAAR.[39]

The question that remains is the appropriate scope of the anti-treaty-shopping presumption set out in *Crown Forest*. Will this presumption be reserved for cases of "treaty shopping," or will it be expanded to cases of "treaty-rule shopping"—that is, cases in which the transaction is structured so as to benefit from the most advantageous rule in a treaty? In *Crown Forest*, the Supreme Court stated that to allow treaty shopping would be contrary to the basis on which Canada ceded its jurisdiction to tax as the source country—namely, that the United States, as the country of residence, would tax the income. However, even if a state is allocated a right to tax under a tax treaty, nothing requires it to exercise that right. Consequently, one might question the soundness of the Supreme Court's reasoning. It seems preferable to interpret the court's pronouncement as simply stating that treaty shopping is contrary to the basis on which Canada agreed to restrict its jurisdiction to tax, namely, that the taxpayer who receives the income in question is a resident of the United States. Since Norsk was not a US resident, there was no reason for Canada to limit its taxing power. If this logic is applied to a treaty-rule shopping transaction—for example, a case in which a US resident shareholder, in order to avoid a deemed

36 Goyette, supra note 1, at 15-18, 71-72, and 75-76.

37 *Dudney*, supra note 12, at 60; *Cheek v. R*, [2002] 2 CTC 2115, at 2124-25 (TCC); *McFadyen v. R*, [2000] 4 CTC 2573, at 2604-6 (TCC); confirmed on this point by 2003 DTC 5015, at paragraph 4 (FCA); leave to appeal to the Supreme Court of Canada denied April 24, 2003, document no. 29591; *Haas Estate v. The Queen*, [2000] 1 CTC 2446, at 2469-70 (TCC); aff'd. [2001] 1 CTC 132 (FCA); leave to appeal to the Supreme Court of Canada denied (2001), 272 NR 196; *Khabibulin v. R*, [2000] 1 CTC 2061, at 2069 (TCC); and *Cloutier v. The Queen*, docket no. 2001-3398(IT)I (TCC) decision dated February 24, 2003, at paragraphs 10 to 13. See also Wilson and Welch, supra note 4, at 6:18-21, on the consistency of courts in applying the treaty interpretation rule proposed in *Crown Forest*.

38 Bowman J stated, supra note 3, at 314, "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."

39 Wilson and Welch, supra note 4, at 6:71; and Toaze, supra note 4, at 909-13.

dividend on the windup of a Canadian corporation, transfers the shares in the latter to another corporation that he controls so as to realize a capital gain for Canadian tax purposes—the conclusion should be the same as that in *Crown Forest*: Canada has ceded its jurisdiction to tax in respect of capital gains. If the United States itself considered that the transaction resulted in a dividend,[40] there would be no reason for the treatment to be different in Canada. This reasoning corresponds to the concordant or symmetrical interpretation advocated in the 1999 thesis, which will be addressed more thoroughly in this article.

GENERAL ANTI-AVOIDANCE RULE

As mentioned above, a significant portion of the 1999 thesis was devoted to the issue of the application of GAAR to the abuse of Canadian tax treaties. The thesis maintained, first, that the wording of section 245—more specifically, that of subsection 245(4), which refers to "a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act . . . read as a whole"—is inadequate in that it does not encompass transactions that abuse treaties, but only those that abuse the ITA.

Second, presuming a modified wording or taking it as given that the current wording is broad enough to encompass treaty abuse, the 1999 thesis proposed that one should examine the symmetry or concordance of treatment that the contracting states apply to a transaction in order to determine whether GAAR is consistent with a particular treaty. In other words, the approach that should be used when one seeks to determine whether GAAR is consistent with a treaty involves an inquiry into the treatment used by the other state that is party to the treaty. Are these conclusions still valid in 2003?

Wording

The wording of section 245 does not cause any problems with respect to transactions that are abusive of the ITA. Consider the following case. First, the paid-up capital of a company resident outside Canada is artificially increased. The company subsequently takes up residence in Canada and amalgamates with a Canadian company so as to allow the shareholder to strip the Canadian company of its surplus while avoiding part XIII tax on the dividends. In this case, it is the ITA that is abused, namely, sections 84 and 128.1 and subsection 212(2). Thus, there is no basis for concluding that the wording of section 245 does not permit the transaction to be attacked. In such cases, the only issue is whether the application of GAAR is consistent with the tax treaty.

In the case of abuse of a treaty, the 1999 thesis concluded that the wording of section 245 does not allow the government to attack the transaction in question for the following three reasons. First, the interpretation of subsection 245(4)—specifically, the expression "an abuse having regard to the provisions of this Act . . . read

40 On this point, see Goyette, supra note 1, at 40-41.

as a whole"—according to the interpretive dictates of the Supreme Court of Canada in effect at the time, leads to the conclusion that this provision does not encompass treaty abuse.[41] Second, the existence in domestic law of provisions that allow for the reduction of taxes to the level provided for in tax treaties (ITA paragraph 81(1)(a) and subparagraph 110(1)(f)(i), and income tax application rule [ITAR] 10(6)) cannot be construed as meaning that an abuse of a treaty is an abuse of those provisions and accordingly an abuse covered by subsection 245(4), since the role of those provisions in the reduction of taxes to the level provided for by treaties is practically non-existent. The benefits provided for by a treaty arise from that treaty and its enabling statute, and those benefits should be granted even in the absence of provisions such as ITA paragraph 81(1)(a) and subparagraph 110(1)(f)(i), and ITAR 10(6).[42] Third, an analysis of the connection between treaties and the ITA shows that they are two separate legal instruments and that an abuse of one does not necessarily entail an abuse of the other.[43]

It would be tempting to suggest that a decision rendered since the publication of the 1999 thesis, *Rousseau-Houle v. The Queen*,[44] supports the argument made in the 1999 thesis with respect to the inadequate wording of section 245. In *Rousseau-Houle*, the transactions had been arranged in such a way as to circumvent regulation 1100(11),[45] which limits the amount of capital cost allowance that a taxpayer may claim in respect of rental properties to the amount of the net income derived in the year from those properties. Having determined that the transactions at issue were avoidance transactions giving rise to a tax benefit, the Tax Court of Canada examined the question whether there had been an abuse within the meaning of subsection 245(4). The court found that the tax benefit obtained by the taxpayer contravened regulation 1100(11). Since subsection 245(4) refers only to abuse of the ITA, the judge took the position that section 245 does not permit an attack on transactions that abuse provisions of the Regulations. In my view, this decision of the Tax Court of Canada is erroneous. Moreover, it should not be invoked in cases of treaty abuse since there are important differences between such cases and cases in which the Regulations are being abused, as in *Rousseau-Houle*. The connection between regulation 1100(11) and the ITA is completely distinct from that which exists between a tax treaty and the ITA.

41 Ibid., at 21-24.

42 The 1999 thesis gave three reasons why it is not ITA paragraph 81(1)(a) or subparagraph 110(1)(f)(i) or ITAR 10(6) that procures the benefits of the treaty but the treaty itself and its enabling statute: (1) the principle that a specific provision shall take precedence over a general tax provision means that a specific exemption provision contained in a treaty shall override a general taxation provision; (2) the decision in *The Queen v. Melford Developments Inc.*, 82 DTC 6281 (SCC), states that any subsequent inconsistent legislation may derogate from a treaty only if it is expressly stated to do so; and (3) the enabling statutes of treaties provide that the latter override any other inconsistent statute. See Goyette, supra note 1, at 25-28.

43 Ibid., at 28-30.

44 2001 DTC 250 (TCC); under appeal to the Federal Court of Appeal, docket no. A-254-01.

45 Income Tax Regulations, CRC 1978, c. 945, as amended.

First, a regulation cannot exist without an enabling statute;[46] thus, regulation 1100(11) could not exist without the ITA. In contrast, tax treaties exist independently of the ITA because they represent an agreement between Canada and another state, an agreement confirmed in domestic Canadian law by a statute other than the ITA. Second, in the case of conflict between a regulation and its enabling statute, the statute takes precedence,[47] while a conflict between the ITA and a treaty must be resolved in favour of the treaty unless the ITA expressly derogates from the treaty. Third, the study conducted in the 1999 thesis demonstrates that it is the treaty and not ITA paragraph 81(1)(a) or subparagraph 110(1)(f)(i), or ITAR 10(6), that procures a tax benefit.[48] However, in the case of capital cost allowance, it is important to understand that paragraph 18(1)(b) prohibits the deduction of any expense of a capital nature or depreciation allowance "except as expressly permitted by this Part," and paragraph 20(1)(a) states that a taxpayer may deduct that part of the capital cost of property "as is allowed by regulation." Without paragraph 20(1)(a) of the ITA, regulation 1100(1), which stipulates the rate of capital cost allowance that may be deducted, would be of no interest to a taxpayer since it would be in conflict with paragraph 18(1)(b) and, as mentioned above, a conflict between a regulation and its enabling statute must be resolved in favour of the legislation. In these circumstances, it may reasonably be asserted that in a case such as *Rousseau-Houle*, it is paragraph 20(1)(a) that is abused, since that provision allows the tax benefit that constitutes the capital cost allowance deduction. There is therefore no problem with the wording of section 245 in attacking this type of transaction.

It is important to be wary of equating transactions that abuse the regulations and those involving tax treaties. That said, in *Rousseau-Houle*, the Tax Court of Canada clearly stated that the steps it took to determine the meaning of the word "Act" in subsection 245(4) were dictated by the principles of interpretation adopted by the Supreme Court of Canada, according to which clear and unambiguous words must be applied notwithstanding their purpose or context.[49] This restrictive approach of the Supreme Court regarding the interpretation of the ITA was also used in the 1999 thesis to analyze the wording of section 245,[50] and there have not been any recent Supreme Court rulings that would suggest that the court intends to override this approach.[51] In contrast, a broad or liberal interpretation could lead a court to determine that an abuse of a treaty is an abuse of the ITA (and therefore that there

46 Patrice Garant, *Droit administratif*, 4th ed., vol. I (Cowansville, QC: Yvon Blais, 1996), 408, 414, 418, and 428-29.

47 René Dussault and Louis Borgeat, *Traité de droit administratif*, 2d éd., vol. 1 (Québec: Les Presses de l'Université Laval, 1984), 519-21.

48 Goyette, supra note 1, at 25-30.

49 Supra note 44, at 259-60.

50 Goyette, supra note 1, at 24.

51 See, for example, *Ludco Enterprises Ltd. v. Canada*, [2001] 2 SCR 1082, at 1100-2, in which the Supreme Court stated that it is not the role of the courts to innovate. The court added that in avoidance cases the provisions of the ITA do not need to be strengthened since the statute

is no problem with the wording of subsection 245(4)) simply because the application of the provisions of the treaty reduces the tax payable under the ITA.[52] Addressed in this manner, the issue of whether the wording of subsection 245(4) is broad enough to cover treaty abuse is reduced to a determination of which of the interpretive approaches, restrictive or broad, will be applied by the courts. As other commentators have described, the tendency of the Supreme Court in recent years has been to interpret the ITA literally but to interpret tax treaties in a broad and liberal manner.[53] In the case of treaty abuse and the wording of subsection 245(4), will the Supreme Court apply a restrictive approach because it is a provision of the ITA; or will it favour a broad and liberal interpretation because, after all, the issue is treaty abuse and, as the court stated in *Crown Forest*, treaty shopping (a type of treaty abuse) should not be encouraged by the interpretation ascribed to a text?

As a last point on the language of subsection 245(4), it should be noted that if the courts follow a literal interpretation and conclude that the current wording of the provision does not allow attacks on transactions that abuse Canadian treaties, it is likely that Parliament will hasten to amend the wording so that there will no longer be any doubt on the matter.

Consistency Between GAAR and Treaties

It has been argued that the restrictive or literal interpretation adopted by the courts with respect to the ITA, combined with the broad and liberal interpretation applied to tax treaties, will ensure that there will be few cases where the issue of consistency between GAAR and tax treaties will arise. Indeed, because of the prevailing strict interpretation of the ITA, there will be few cases where GAAR will apply. In those cases where GAAR does apply, the broad approach to the interpretation of treaties will lead the courts to interpret them in such a way as to avoid concluding that there exists a conflict between a treaty and GAAR.[54] To this, it should be added that the

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contains a number of anti-avoidance provisions and that Parliament may intervene if it wishes to counter other practices.

52 This argument is related in Wilson and Welch, supra note 4, at 6:35, and appears to correspond to the approach adopted by many states that have taken the position that domestic anti-abuse rules may be applied in treaty abuse situations (see paragraph 9.2 of the commentary on article 1 of the model convention, supra note 18). This argument differs from the one set out in the 1999 thesis, supra note 1, at 29, according to which an abuse of the treaty is an abuse of the ITA because the tax treaty modifies the statute and because the ITA contains provisions that ensure the reduction in taxes to the levels provided for in the treaty at issue. This last argument is weaker than that related by Wilson and Welch because it overlooks the fact that the ITA and a Canadian tax treaty are two distinct legal instruments and because the effect of the ITA provisions providing for a reduction in taxes at the treaty level is virtually non-existent. On this point, see Goyette, supra note 1, at 24-30.

53 Wilson and Welch, supra note 4, at 6:12-22, 6:36-43, and 6:52-53. Since the appearance of that paper, the Supreme Court has applied a type of restrictive interpretation of the ITA in the following cases: *Ludco Enterprises*, supra note 51, at 1100-2; and *Brian J. Stewart v. The Queen*, 2002 DTC 6969, at 6978 (SCC).

54 Wilson and Welch, supra note 4, at 6:6, 6:7, and 6:52-54.

issue of consistency will not arise in cases of abuse of the Canada-US treaty because of the existence of article XXIX A(7), which provides that states may deny treaty benefits in cases of abuse. This element is particularly important given the volume of trade between these two countries, which is the largest in the world.

As well, the issue of consistency between GAAR and a treaty will not arise when a provision of the treaty includes an invitation to apply a domestic anti-abuse provision, as was the case in *RMM Canadian Enterprises*.[55] The issue in that case was whether a US resident was correct in claiming that it had realized a capital gain rather than a dividend in respect of shares in a Canadian corporation. Article X(3) of the Canada-US treaty provides that the term "dividends" means "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." On the basis of this wording and the OECD commentary on the model convention, which indicates that a provision such as article X(3) applies to a disguised distribution of profits such as that which confronted the court, Bowman J determined that the taxpayer had received dividends. To that conclusion it should be added that in a case such as *RMM Canadian Enterprises*, in which the treaty provision calls for the application of a domestic anti-abuse measure such as section 245, there would be no question of inconsistency between that measure and the treaty since the treaty itself calls for the result ordered by the domestic anti-abuse rule.[56]

In contrast, it is reiterated in this article that neither article III(2) of most Canadian tax treaties nor section 3 of the Income Tax Conventions Interpretation Act[57] resolves the issue of consistency between GAAR and Canadian tax treaties. These two provisions state that any term or expression used in the treaty that is not defined therein has, *unless the context otherwise requires*, the meaning assigned to it under the domestic law of the state that applies the treaty. Some see in these provisions an authorization to apply domestic anti-abuse rules and conclude from this that there can be no inconsistency between domestic anti-abuse rules and treaties. Moreover, an obiter dictum of Bowman J of the Tax Court of Canada in *RMM Canadian Enterprises*[58] supports that opinion. The 1999 thesis presented a different opinion, based on the fact that article III(2) of Canada's treaties, like section 3 of the Income Tax Conventions Interpretation Act, requires that the context be taken into account in determining whether recourse to domestic law is possible. The domestic context, as well as the external treaty context, indicates that domestic anti-abuse rules are not defining provisions to which recourse would be permitted under article III(2) of the treaties and section 3 of the Income Tax Conventions Interpretation Act. With respect to the domestic context, it must be noted that article III(2) of the treaties is entitled "General Definitions," which indicates that this

55 Supra note 3.

56 Goyette, supra note 1, at 32-33.

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

58 Supra note 3, at 311 and 315.

article is concerned only with the definition of concepts, rather than a general reference to broad domestic law. In addition, the fact that the treaties contain some provisions that call for the application of general domestic law and other provisions that rely on the domestic law of a state only for definition purposes indicates that article III(2) of Canadian treaties provides for recourse to Canadian domestic law for definition purposes only. With respect to the external context of article III(2) of Canadian treaties and section 3 of the Income Tax Conventions Interpretation Act, the 1999 thesis argued that the OECD commentary concerning a similar provision of the model convention limited the scope of this provision to matters of definition.[59]

On the basis of the premise that article III(2) of the treaties and section 3 of the Income Tax Conventions Interpretation Act do not resolve the question of consistency between domestic anti-abuse rules and tax treaties, the 1999 thesis suggested two methods or approaches that may be used to determine whether GAAR is consistent with tax treaties: the transactional and the interpretive approaches.

"Transactional" Approach

The "transactional" (or "true nature") approach is a factual approach that justifies the application of a domestic anti-abuse measure such as GAAR on the basis that it is, in reality, an instrument for discovering the true facts to which the treaty must be applied. Before January 2003, the OECD commentary seemed to indicate that this approach was endorsed by OECD member countries only in cases of abuse involving base companies.[60] However, effective January 28, 2003, the commentary on article 1 of the model convention indicates that the transactional approach has been adopted by many states in order to justify the application of domestic anti-abuse rules to all kinds of situations involving treaty abuse.[61]

The 1999 thesis cited Scott Wilkie and Heather Kerr[62] in support of the use of the transactional approach in Canada. In their view, it is necessary to examine the true nature of a transaction or a series of transactions in order to determine whether it is appropriate to use GAAR in a given case. Moreover, they suggest, an examination of the true nature of a transaction involves an inquiry into its legal substance (although they do not offer a definition of legal substance). It was stated previously that the Supreme Court of Canada has severely restricted the principle of substance over form. In fact, the primacy of economic substance over form can no longer be invoked in Canada. According to the Supreme Court, the legal substance of a transaction must still prevail over its form. The difficulty is that the court determines

59 Goyette, supra note 1, at 33-36. See also Wilson and Welch, supra note 4, at 6:61-62.

60 Goyette, supra note 1, at 36 and 65-67. A base company is a company established in a low-tax jurisdiction as a tax shelter for the purpose of reducing the taxes owed in the country of residence of the taxpayer. On this point, see *International Tax Avoidance and Evasion*, supra note 15, at 60-64.

61 See paragraph 9.2 of the commentary on article 1 of the model convention, supra note 18.

62 J. Scott Wilkie and Heather Kerr, "Common Links Among Jurisdictions: Informing the GAAR Through Comparative Analysis," in *Report of Proceedings of the Forty-Ninth Tax Conference*, 1997 Conference Report (Toronto: Canadian Tax Foundation, 1998), 34:1-30, at 34:28-30.

the legal substance of a transaction simply on the basis of the legal documentation submitted by the taxpayer.[63] In other words, the court determines the substance of a transaction on the basis of its form. In these circumstances, there are grounds to question the possibility of using the transactional approach in Canadian law.

This concern is all the more relevant after the ruling by the Federal Court of Appeal in *The Queen v. Canadian Pacific Limited*.[64] In that case, the issue to be decided by the court was whether GAAR applied to a loan made in a foreign currency so as to obtain a greater tax benefit than that resulting from a loan denominated in Canadian dollars. The minister of national revenue argued that the transaction was an abuse of the ITA since, in reality, the payments representing the difference between the amount paid on the loan and the prevailing Canadian interest rate for a similar borrowing were not deductible interest payments, but rather non-deductible repayments of principal. The court rejected this argument because the document establishing the transaction at issue, the debenture agreement, characterized the payments as interest. Like the Supreme Court, the Federal Court of Appeal analyzed the substance of a transaction solely on the basis of the language used in the documentation, without questioning whether those words accurately reflected the true nature of the transaction. Moreover, the Court of Appeal agreed with the Tax Court that the minister of national revenue had "put the cart before the horse"[65] when he tried to characterize the interest payments in other terms in order to argue that the transaction was an abuse of the ITA. According to the Court of Appeal, section 245 expressly authorizes the recharacterization of a transaction, but only after it has been established that there has been an avoidance transaction and that there would otherwise be a misuse or an abuse. The court stated, "A transaction cannot be portrayed as something which it is not, nor can it be recharacterized in order to make it an avoidance transaction."[66]

These comments by the Court of Appeal are troubling. It is true and important to emphasize that subsection 245(3), which defines "avoidance transaction," does not allow a transaction to be "recharacterized" in order to determine whether or not it is an avoidance transaction. The explanatory notes are clear that subsection 245(3) does not allow a transaction to be considered an avoidance transaction because another transaction, one that would have given an equivalent result, would give rise to higher taxes.[67] On the other hand, as pointed out by Brian Arnold,[68] the same

63 For example, in *Continental Bank Leasing v. Canada*, [1998] 2 SCR 298, the Supreme Court relied on the documentation and forms submitted to determine whether the substance of the transaction was the creation of a true partnership or a disguised sale of shares.

64 2002 DTC 6742 (FCA).

65 Ibid., at 6750: Sexton JA quoting Bonner TCCJ, *Canadian Pacific Limited v. The Queen*, 2000 DTC 2428, at paragraph 16 (TCC).

66 Supra note 64, at 6750.

67 Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (Ottawa: Department of Finance, June 1988), clause 186.

68 Arnold, "Statutory Interpretation and Tax Avoidance," supra note 28, at 30.

explanatory notes indicate that subsection 245(4) takes into consideration the fact that the provisions of the ITA cover transactions that have an economic rationale and not transactions that aim to exploit, circumvent, or frustrate the provisions of the Act in order to avoid taxation. According to Arnold, this means that even if GAAR does not institute an economic substance over form rule, it requires or permits that the economic substance or commercial reality of a transaction or a series of transactions be taken into consideration in order to determine whether the transaction or series results in an abuse within the meaning of subsection 245(4). Moreover, in three cases in which it was necessary to determine whether the taxpayer had engaged in surplus stripping, a transaction that was deemed abusive, the Tax Court of Canada examined the economic substance or commercial reality of the transaction at issue.[69] Without such an examination, it would never have been possible to make a finding of surplus stripping since the court would have had to confine itself to the sale of shares as described in the documentation.

It is thus to be hoped that the courts will not follow the comments made by the Federal Court of Appeal concerning the impossibility of examining the true nature of a transaction in the determination of an abuse under subsection 245(4). The transactional or true nature approach to a transaction should be used in Canada when it is necessary to determine whether the application of GAAR is consistent with a treaty. Not only is this approach supported by the OECD commentary, but also, and more important, it falls in line with the symmetry of treatment proposed in the 1999 thesis as a method for resolving the issue of consistency between GAAR and treaties. Moreover, it accords with the interpretive approach.

Interpretive Approach

In the 1999 thesis, I stated that the interpretive approach could not be ignored in the resolution of the issue of consistency between GAAR and Canadian treaties. The reason given was that the transactional approach was endorsed by the OECD commentary only in cases of abuse concerning base companies; that the commentary required that the spirit of treaties be taken into consideration in the determination of whether a domestic anti-abuse rule must be applied; and that such consideration implied an interpretation of treaties. As stated above, as of January 28, 2003, the commentary indicates that for many states, the transactional approach applies to all types of treaty abuse, not just abuse involving base companies. However, the new commentary also provides that in other states, recourse to domestic anti-abuse measures is justified by the fact that treaties must be interpreted in good faith, in light of their object and purpose.[70] Moreover, the revised commentary reiterates the need for treaty interpretation by suggesting, as a guiding principle in the determination of whether a transaction constitutes an abuse of a treaty, that the object and

69 *RMM Canadian Enterprises*, supra note 3, at 313; *McNichol et al. v. The Queen*, 97 DTC 111, at 120-22 (TCC); and *Nadeau v. R*, [1999] 3 CTC 2235, at 2250 (TCC).

70 See paragraph 9.3 of the commentary on article 1 of the model convention, supra note 18.

purpose of the relevant provisions of the treaty should be considered.[71] Given that the commentary still requires an interpretation of treaties, and because of the impact that the Federal Court of Appeal's decision in *Canadian Pacific* could have on the application of the transactional approach in Canada, the interpretive approach should be considered in resolving the issue of consistency between GAAR and Canadian tax treaties.

The interpretive approach is simply described: it involves the interpretation of a treaty to determine whether the treaty allows GAAR to be applied in a particular case. Given that Canada is bound by the Vienna convention and that many decisions of Canadian courts refer to that convention, the interpretive approach must respect the rules of interpretation set out in articles 31, 32, and 33[72] of the Vienna convention.[73] The interpretive criteria of the convention were analyzed in the 1999 thesis, and it would be superfluous to repeat the exercise here. For the purposes of this article, it will suffice to reiterate these criteria and to comment on subsequent events that could modify the conclusion reached in the 1999 thesis.

Interpretive Criteria

The Vienna convention requires interpretation in good faith. This means that when one seeks to determine whether GAAR is consistent with a treaty in a given case, it is important to find the interpretation most likely to be accepted by the two parties to the treaty (the "concordant" interpretation), as well as the interpretation that complies with international jurisprudence on the question.[74]

Concordant Interpretation

With respect to concordant interpretation between contracting states, the 1999 thesis presented two examples in order to illustrate the issues that underlie concordant interpretation when the question to be addressed is treaty abuse. These examples will be discussed below under the heading "Concordance, Symmetry, or Reciprocity." The 1999 thesis also reported the tendency of Canadian courts to adopt the interpretation of a treaty provision ascribed by the other contracting state, unless that interpretation is obviously incorrect. Since 1999, there has been a decision in which the judge sought a concordant interpretation of the word "resident" contained in the treaty between Canada and Japan[75] and another decision, *Haas Estate v. The Queen*,[76] in which the court made comments on the reciprocity of a treaty that warrant discussion.

71 See paragraph 9.5 of the commentary on article 1 of the model convention, ibid.

72 Article 33 deals solely with the issue of interpreting the different linguistic versions of a treaty.

73 Goyette, supra note 1, at 37.

74 Ibid., at 38-39.

75 *McFadyen*, supra note 37, at 2604-8 (TCC).

76 *Haas Estate*, supra note 37.

In *Haas Estate*, the Federal Court of Appeal was called upon to review the decision it had rendered in *Kubicek Estate v. R.*[77] At issue in both cases was the interpretation of article XIII(9) of the Canada-US treaty,[78] which provides a formula to reduce the capital gain realized by a non-resident that is subject to tax by the country of source. This reduction in the gain was introduced in order to recognize the fact that as a general rule, before January 1, 1985, only the country of residence could tax the capital gain realized by one of its residents in the other contracting state.[79] Since, after January 1, 1985, the source country is allowed to tax capital gains, the formula provided in article XIII(9) of the treaty excludes from source country taxation the portion of the gain attributable to the holding period of the property ending December 31, 1984. (January 1, 1985 is the date on which the new treaty came into force.) The problem is that the formula specifies the termination date but not the commencement date of the holding period in respect of which the exclusion applies. According to the Canada Customs and Revenue Agency, for Canadian tax purposes, article XIII(9) indicates that the holding period to be considered runs from January 1, 1972 (the date on which capital gains became taxable in Canada) to December 31, 1984. According to the appellants in *Kubicek Estate* and *Haas Estate*, the gain should instead be reduced for the entire holding period up to December 31, 1984—that is, from the date of acquisition of the property, even if it preceded January 1, 1972.

In *Kubicek Estate*, the Federal Court of Appeal found in favour of the Canadian tax authorities on the basis that, since the word "gain" used in article XIII(9) was not defined by the treaty, article III(2) of the treaty and section 3 of the Income Tax Conventions Interpretation Act[80] required that this term be given the meaning that it has in domestic law. In the Canadian context, this means that the word "gain" alludes to the capital gain realized after December 31, 1971. In arriving at its conclusion, the court did not attach importance to the US Treasury department's technical explanation (even though it was endorsed by Canada's minister of finance), which provided that the gain should be reduced by the country of source taking into account the period during which the property was held up to and including December 31, 1984. In *Haas Estate*, the appellant asked the Court of Appeal to reconsider its earlier decision in light of various US documents that showed that in the United States, the application of the gain reduction formula provided for in article XIII(9) of the treaty included the entire holding period of the property up to December 31, 1984. The court refused to agree to this request since the context of the treaty had the effect of limiting the scope of the expression "total gain" as used in the

77 [1997] 3 CTC 435 (FCA); leave to appeal to the Supreme Court of Canada denied, docket no. 26334, March 12, 1998.

78 Supra note 12.

79 In fact, the source country could tax the gain in the sole event that the taxpayer had a permanent establishment in that country.

80 Supra note 57.

technical explanation to the amount of the gain realized after December 31, 1971, for purposes of the application of the formula in Canada. Moreover, Rothstein JA stated:

> 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 capital gain tax purposes as there is in Canada. *Thus, perfect symmetry will not be achieved by the 1980 Convention* [emphasis added].[81]

These comments by Rothstein JA refer to a fundamental element of concordant interpretation or symmetry of treatment mentioned in the 1999 thesis: concordant interpretation does not mean that the two contracting states must apply identical treatment to a transaction. Rather, it is necessary to consider how each contracting state perceives the transaction in order to bring about a symmetrical application of the treaty based on the true nature of the transaction. Also, this concordant interpretation or symmetry of treatment means that one must search for an interpretation of the treaty that corresponds to that ascribed by the other state, unless, of course, the latter is unreasonable. In *Haas Estate*, the interpretation proposed by the appellant would not yield a more symmetrical result because its effect would be to obtain a greater reduction in the gain for Canadian tax purposes, such that the "gain" would always be lower in Canada than in the United States, unless there had been no increase in value between the date of acquisition and December 31, 1971. Moreover, given that the United States taxes the capital gain for the entire holding period of the property, it is reasonable to conclude that in the US context, the word "gain" in article XIII, which must have the meaning it has in domestic law, refers to the gain accrued or realized between the moment of purchase and December 31, 1984. In the Canadian context, given that Canada began taxing capital gains only after December 31, 1971, the word "gain" can only have the meaning assigned to it by the Federal Court of Appeal. This conclusion complies with concordant interpretation: in both cases, an exemption for the gain accrued or realized before January 1, 1985 is granted, and that is the purpose of article XIII(9).

International Jurisprudence

With respect to international jurisprudence, the 1999 thesis concluded:

> Not surprisingly, there is a certain degree of support in the international jurisprudence for the application of internal anti-abuse rules in situations of treaty abuse. However, this support is mitigated by two factors: (1) the decisions do not unanimously support the application of internal anti-abuse rules, and (2) a number of cases require some

81 *Haas Estate*, supra note 37, at 135.

> indication from the contracting states and their treaty whether these rules can be applied.[82]

There have been some developments since I made that comment, but nothing suggesting that a majority of countries are of the same mind on the issue of consistency between domestic anti-abuse rules and tax treaties. Nevertheless, in three of the four countries examined, the courts have permitted the application of domestic anti-abuse rules in cases of treaty abuse.

In France, the country's highest court, the Conseil d'État, ruled on the issue of consistency between section 209B of the General Tax Code and the France-Switzerland treaty. (Section 209B is comparable to section 91 of the ITA and taxes the French-resident shareholder on the profits of a foreign affiliate subject to a preferential tax rate.) In that case, *Schneider Electric*,[83] the facts were straightforward: Schneider, a company resident in France, held all of the shares in Paramer, a company resident in Switzerland, whose only activity was the management of an investment portfolio. The French tax authorities decided to tax Paramer's profits under section 209B.

At trial, the Tribunal administratif de Paris found in favour of the tax authorities. This decision was, however, contrary to a decision by the Tribunal administratif de Strasbourg on the same issue. The Cour administrative d'appel de Paris,[84] and subsequently the Conseil d'État, found in favour of Schneider. According to the Conseil d'État, the profits that France sought to tax pursuant to section 209B were those of Paramer. Yet, article 7 of the France-Switzerland treaty provides that the profits of a business of a contracting state are taxable only in that state, unless the business is carrying on its activities in the other state through a permanent establishment. Because Paramer had no permanent establishment in France, the latter could not tax the company. Furthermore, the Conseil d'État declared that the objective of combatting tax fraud or evasion, assuming that this was one of the objectives of the France-Switzerland treaty, did not permit, in the absence of a specific provision to the contrary, derogation from the terms of the treaty. Consequently, section 209B could not be applied because it yielded a tax result different from that provided for by the treaty.

A few months before the decision in *Schneider Electric*, Finland's Supreme Administrative Court, the country's highest administrative judicial body, reached a decision contrary to that of the French Conseil d'État in concluding that the controlled foreign corporation (CFC) rules are consistent with the Finland-Belgium tax treaty.[85] Similar to Canada's foreign accrual property income rules and France's section 209B discussed above, Finland's CFC rules seek to tax in the hands

82 Goyette, supra note 1, at 52.

83 *Ministre de l'économie, des finances et de l'industrie c. société Schneider Electric*, Conseil d'État, decision no. 232276—June 14, 2002 hearing, reading on June 28, 2002.

84 CAA Paris, *SA Schneider*, no. 96-1408, January 30, 2001.

85 *A Oyj Abp*, supra note 22.

of the Finnish shareholder passive-type income earned by a foreign affiliate subject to low tax. In the *A Oyj Abp* case, the facts were quite similar to those of *Schneider Electric*: A Oyj Abp held the shares of a Belgian-resident company ("Finance") whose activities consisted of financing A Oyj Abp's European subsidiaries. Finance benefited from a preferential tax regime in Belgium, and its activities were of a passive nature. Accordingly, the Finnish tax authorities sought to apply Finland's CFC rules and tax A Oyj Abp on the profits earned by Finance. The Supreme Administrative Court held that the CFC rules applied, notwithstanding article 7 of the Finland-Belgium treaty. Like article 7 examined in *Schneider Electric*, article 7 of the Finland-Belgium treaty provides that the profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a permanent establishment. In the view of the Supreme Administrative Court, even if Finance did not have a permanent establishment in Finland, Finland could apply its CFC rules to tax Finance's profits because the OECD commentary on the model convention[86] indicates that the majority of OECD members consider that CFC legislation does not contravene tax treaties. The fact that the OECD commentary was issued after the signing of the Finland-Belgium treaty did not trouble the Supreme Administrative Court. The Court indicated that even if the commentary in force when a treaty is concluded has more weight than the subsequent commentary, the latter is nevertheless an important interpretive aid.[87]

It seems that the article regarding dividends found in most tax treaties based on the OECD model convention allows countries to have recourse to their CFC rules in order to tax profits earned by a foreign corporation.[88] There is therefore no conflict between CFC legislation and tax treaties that contain a provision similar to article 10 of the model convention. Thus, the decision of the Finnish Supreme Administrative Court is correct and should prevail over the decision of the French Conseil d'État, even if, for some commentators, the cogency of the reasons on which the Finnish court based its decision is questionable.[89]

In Germany, the highest taxation court, the Federal Tax Court, refused to apply the general anti-abuse measure in section 42 AO of the General Tax Code in two cases involving the German CFC rules.[90] Those rules tax German shareholders on a

86 Supra note 18.

87 See *A Oyj Abp*, supra note 22, at 1065, 1066, 1071, and 1072.

88 Lang, supra note 22, at 55-58.

89 Ibid., at 51-58. See, however, paragraph 23 of the commentary on article 1 of the model convention, supra note 18. The text of paragraph 23 has been modified since January 28, 2003 to provide that CFC legislation does not conflict with article 7 or with article 10 of tax treaties based on the model convention. See also paragraph 10.1 of the commentary on article 7 and paragraph 37 of the commentary on article 10, ibid.

90 The Federal Court rendered this decision in two cases: see the decision of January 19, 2000 (I-R-117/97), published in BFH/NV-2000-0824, and the decision of January 19, 2000 (I-R-94/97), published in BStBl. 2001 II, at 222. For a discussion on the topic, see "Germany: 203:

"supplemental income amount"—that is, passive income earned by a foreign subsidiary subject to a low rate of tax. For the years in issue, the CFC rules exempted from taxation supplemental income amounts that would be exempt by virtue of the participation privilege of an applicable tax treaty.[91] In the cases submitted to the Federal Tax Court, two German corporations had formed an Irish corporation in which they had invested DM 70 million. The activities of the Irish corporation were the passive management of assets, and a third-party corporation was engaged to handle investment transactions. The assets of the Irish corporation were German bonds. The Irish corporation enjoyed a preferential 10 percent tax rate and the Germany-Ireland treaty contained a participation privilege. Accordingly, the income earned by the Irish corporation escaped the CFC rules and could be subject indefinitely to a tax rate of only 10 percent. Since the CFC rules were not applicable, the German tax authorities challenged the structure under section 42 AO of the General Tax Code, which provides that a taxpayer cannot avoid tax through the abuse of legal structures. Section 42 AO further provides that, in the case of such abuse, the tax consequences of the transaction will be those that would have followed from a structure appropriate to the economic transaction that was carried out. In the case of the Irish corporation, the court concluded that the CFC rules permitted the transactions at issue and that, because the Irish corporation was not merely a "letterbox" company, those CFC rules pre-empted the application of section 42 AO. In the court's view, the fact that the CFC rules permitted the result challenged by the tax authorities demonstrates legislative acceptance of the structure used by the taxpayers. Finally, the court considered that the 1992 amendments to the CFC rules, which deny the exemption provided by the treaty in a case such as that before the court, provide further evidence that before 1992, the intention of the legislator was to exempt from tax transactions such as those at issue. Following these two decisions, the German government added a second paragraph to section 42 AO providing that, unless specifically excluded by statute, the general anti-abuse rule of section 42 AO applies, even where specific anti-abuse rules address the issue. In a recent decision,[92] the Federal Tax Court had occasion to consider whether amended section 42 AO applied in respect of a structure that escaped the application of the German CFC rules. The court did not rule on the impact of the amendments since it considered that the structure used by the taxpayers was simply not abusive. That conclusion was based on the fact that the foreign corporation incurred a financial risk and was more than a mere "letterbox" company.

It should be noted that in the above three cases, the court did not challenge the possibility of applying a domestic anti-abuse rule such as section 42 AO to a treaty, but concluded that in the circumstances, that rule was not applicable. In addition,

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Interposition of Irish ISFC Respected for Tax Purposes: Dublin Docks—KPMG," Mondaq Ltd., Quicklaw, July 14, 2000.

91 In general terms, the participation privilege exempts from taxation the income of a shareholder who holds a certain percentage of interest in the corporation that is paying the income.

92 BFH/NV-2002-1197 (Part BFH/R).

in the first decision that it rendered on the question of the treaty anti-abuse rule provided in the Income Tax Code, the Federal Tax Court confirmed that it is possible to apply a domestic anti-abuse rule to transactions that are abusive of a treaty.[93] In that case, a Dutch BV was interposed between a German GmbH and its shareholder, a Bermudan company owned by individuals resident in Bermuda (85 percent), Australia (7.5 percent), and the United States (7.5 percent). In 1994, the GmbH distributed a dividend of DM 910,000 to the BV. The BV requested a refund of the difference between the 25 percent rate of German withholding tax and the 5 percent rate provided under the Germany-Netherlands treaty. The German tax authorities denied the reduced withholding tax rate. In so doing, the tax authorities relied on section 42 AO of the General Tax Code as well as on the anti-treaty-abuse provision found in section 50d(Ia) of the Income Tax Code.[94] The latter provides that a foreign corporation may not claim a tax benefit where its shareholders would not have been entitled to the benefit if they had earned the income directly, and where there is no business or other bona fide purpose for interposing a foreign corporation that has no business activity of its own.

The court first addressed the application of section 42 AO and concluded that this provision applies to corporate shells that lack substance, whether or not they reside in tax havens. The court then acknowledged the necessity of respecting legal structures put in place by taxpayers except in cases where those structures are deceptive and without economic justification. Since the Dutch BV had no economic activities, the mere holding of shares of a German GmbH is not an economic activity, and reasons such as coordination, organization, and local preferences (the group had other companies in the Netherlands) were not sufficient to justify the structure interposing a Dutch BV, the Federal Court applied section 42 AO. For the same reasons, the court also applied section 50d(Ia) in order to deny the reduced withholding rate. In the court's view, there is no difference between a German tax treaty and any other statute since in both cases Parliament's consent is required. Accordingly, the court concluded that Parliament is free to overrule a tax treaty, as long as it expressly states that such is its intention.

Finally, in a US decision, *Del Commercial Properties Inc. v. Commissioner*,[95] the US Court of Appeals for the District of Columbia Circuit defeated a scheme involving back-to-back loans, scorning interposed transactions involving other entities and treating the arrangement as a direct lending transaction between a Canadian corporation and a US corporation. The court thus concluded that the rate of withholding tax that the United States could levy on interest paid by the US corporation was the rate specified in the Canada-US treaty and not that provided for by the US-Netherlands

93 BFH/NV-2002, at 1202. For a discussion of the decision, see Thomas Schäefer and Thorsten Vree, "Court Clarifies Substance Standard Under Anti-Abuse Rules" (July/August 2002), *World Tax Advisor: International Tax Developments* (Deloitte Touche Tohmatsu), 7-8; and Albert Baker, "European Tax Cases" (September 24, 2002) vol. 10, no. 9 *Canadian Tax Highlights* 66.

94 The provision is now found in section 50d(3) of the Income Tax Code.

95 251 F.3d 210 (CA-DC 2001).

treaty. The interesting point, for the purposes of this article, is that the US Court of Appeals did not address the question whether the US-Netherlands treaty raised any obstacle to the setting aside of the Dutch intermediary. The court applied the domestic anti-abuse rules, notably the step-transaction doctrine, and then applied the treaty, which governed the true transaction concluded by the taxpayer.

As mentioned previously, there is no international consensus on the issue of consistency between domestic anti-abuse rules and treaties, but support for the application of those rules persists. In two countries, courts addressed the issue of consistency between domestic CFC rules and tax treaties. In France, the court refused to apply these rules because they yielded a result different from that provided for in the treaty, while in Finland, the court concluded that the OECD commentary on the model convention permitted this different result. In Germany, the courts considered the possibility of applying a domestic general anti-abuse rule to remedy deficiencies in the CFC rules and concluded that in the particular circumstances of the case, the general anti-abuse rule could not be applied. However, the German courts did not question the possibility of applying a domestic anti-abuse rule to transactions constituting abuse of a treaty. Moreover, in another German decision, the result yielded by the domestic anti-abuse rule was confirmed even if it differed from the result contemplated by the treaty since the legislator had clearly expressed the treaty override. Finally, in the United States, the domestic anti-abuse rule was applied without any consideration of the question whether this rule was consistent with the treaty.

Ordinary Meaning of Words

The Vienna convention requires that the interpretation of a treaty must respect the *ordinary meaning of the words*, in their context and in light of the treaty's object and purpose. If Canadian treaties stipulated when and to what extent domestic anti-abuse rules could be applied to abuses of those treaties, the task of interpretation would be greatly facilitated. In fact, this would resolve the issue of consistency between section 245 and the treaties since the commentary on the Vienna convention attaches a great deal of importance to the wording of a treaty. The 1999 thesis pointed out that, other than the Canada-US treaty, Canadian treaties are silent on the application of domestic anti-abuse rules.[96] Since then, the Canada-Germany treaty[97] has been concluded, and it provides, in article 29(6), that no provision of the treaty "shall be construed as preventing a Contracting State from denying benefits under the Agreement where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of the Agreement or of the domestic laws of that State." An official in the Department of Finance has stated that this provision

96 Goyette, supra note 1, at 52-53.

97 Agreement Between Canada and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Income and Certain Other Taxes, the Prevention of Fiscal Evasion and the Assistance in Tax Matters, signed at Berlin on April 19, 2001.

was included at Germany's request, and one may assume that the negotiations to conclude the treaty with Canada were under way at a time when German jurisprudence held that treaties did not permit the application of domestic anti-abuse measures. Regardless of the reasons underlying the insertion of article 29(6), it now appears from the clear language of that provision that GAAR may be applied when there has been an abuse of the Canada-Germany treaty. The fact that two Canadian treaties specifically provide for the application of domestic anti-abuse measures raises the question whether it should be inferred from the absence of such clear language in other Canadian treaties that domestic anti-abuse measures cannot be applied to abuses of those other treaties. This issue is addressed below under the heading "Context" relating to treaties.

Object and Purpose

According to article 31(1) of the Vienna convention, a treaty is to be interpreted in light of its object and purpose. The 1999 thesis stated that, in *RMM Canadian Enterprises*,[98] the Tax Court of Canada invoked the object and purpose of the treaty in support of the conclusion that that there could be no place for an interpretation that permits treaty abuse. According to the recent OECD commentary on the model convention, the position expressed in *RMM Canadian Enterprises* is shared by some states. These states consider, in effect, that a proper interpretation of treaties—that is, an interpretation in good faith that takes into account the object and purpose of treaties—entitles them to disregard transactions that are abusive of tax treaties. According to the commentary, the object and purpose of relevant treaty provisions will determine whether a transaction is abusive and, thus, whether it is possible to apply a domestic anti-abuse rule.[99]

The 1999 thesis reported that in Canada, the Supreme Court decision in *Crown Forest*[100] raised the object and purpose of the treaty to the status of an interpretive principle, applicable in all cases involving tax treaties.[101] One interesting aspect raised by the ruling in *Crown Forest* pertains to the conflict that could arise between the interpretive criterion of the ordinary meaning of words and that of object and purpose. As previously stated, in *Crown Forest*, the Supreme Court was called upon to determine whether the Norsk corporation was resident in the United States for the purposes of the application of the Canada-US treaty. The court found that Norsk was not resident in the United States because the plain

98 Supra note 3.

99 Paragraphs 9.3 and 9.5 of the commentary on article 1 of the model convention, supra note 18.

100 Supra note 6.

101 Without that ruling by the Supreme Court of Canada, it seems that the object and purpose of the treaty would likely be only an aid in the interpretation process and not a separate interpretation criterion because of the wording of paragraph 1 of article 31 of the Vienna convention, which provides that a treaty is to be interpreted "in the light" of its object and purpose. Goyette, supra note 1, at 53.

language, the intention of the drafters, and the purpose of the treaty pointed to this conclusion. In many cases of treaty abuse, the ordinary language of the treaty permits the transaction carried out by the taxpayer and, furthermore, this language is, with two exceptions,[102] silent on the question of the application of domestic anti-abuse rules to transactions that constitute treaty abuse. In such circumstances, how would the Supreme Court reconcile the result obtained from an analysis of the language of the treaty with that of the intention of the parties to the treaty? As mentioned above, the tendency of the Supreme Court in recent years has been to interpret the ITA literally and to interpret tax treaties in a broad and liberal manner. On the one hand, there are cases in which the Supreme Court adopted an interpretation giving precedence to the clear language of an ITA provision over its object and purpose.[103] On the other hand, there are passages in *Crown Forest* in which Iacobucci J recommends a liberal interpretation of treaties while emphasizing the importance of the intention of the drafters of treaties, as well as the significant relevance of the purpose of treaties.[104] In that context, it seems preferable not to speculate on how the Supreme Court would reconcile the language of a treaty with its object and purpose in order to determine whether a domestic anti-abuse rule can be invoked in a case of treaty abuse. It may well be that the position of the Supreme Court would depend on the clarity of the language as compared with the clarity of the object and purpose of the treaty. On the basis of that premise, one must question what exactly is the object or purpose of treaties.

One of the objects of treaties is certainly the elimination of double taxation.[105] Thus, there will be a greater chance that an interpreter will find inconsistency between a domestic anti-abuse measure such as GAAR and a treaty if the application of that domestic measure would lead to double taxation. The 1999 thesis emphasized that one of the most important purposes of treaties is the distribution of taxing powers between contracting states. This means that, in taking into account the object of a treaty as an element of interpretation in determining whether or not a domestic anti-abuse rule is consistent with the treaty, one must question to which party the contracting states wished to allocate the taxation power with respect to the disputed income.[106] Moreover, as suggested in the 1999 thesis, when a treaty is interpreted in light of its object or purpose, this criterion must be applied objectively, not subjectively.[107]

102 The Canadian treaties with Germany and the United States.

103 *Canada v. Antosko*, [1994] 2 SCR 312, at 326-27; *Friesen v. Canada*, [1995] 3 SCR 103, at 113-14; *Singleton*, supra note 30, at 1058; and *Ludco Enterprises*, supra note 51, at 1101.

104 Supra note 6, at 821-22. See also Wilson and Welch, supra note 4, at 6:18-21, on the persistent tendency of the courts to apply the rule of treaty interpretation proposed in *Crown Forest* and to favour a liberal interpretation that takes into account the intention of the parties to the treaty.

105 See, for example, *Haas Estate*, supra note 37, at 135 (FCA).

106 Goyette, supra note 1, at 54-55; and *Coblentz*, supra note 12, at 6534-35.

107 Goyette, supra note 1, at 55.

Since 1999, the Federal Court Trial Division has rendered a decision in *Chua v. Minister of National Revenue*.[108] In that decision, the court stated that tax treaties have two primary objectives: to avoid double taxation and to permit governments to collect amounts due to them by dividing these amounts between them and by combatting tax *avoidance* and evasion.[109] As this is the second time that the Federal Court has declared that one of the purposes of tax treaties is to combat tax avoidance,[110] this may be the beginning of a trend toward clear interpretation in this regard. If the courts were to uphold this trend, they could find it easier to rule that the interpretation of tax treaties on the basis of their object or purpose authorizes the application of a domestic anti-abuse rule such as GAAR in cases of treaty abuse. Moreover, it is possible that the recent revisions to the OECD commentary may persuade the courts to consider that one purpose of tax treaties is to prevent tax avoidance. Formerly, paragraph 7 of the commentary on article 1 of the model convention[111] stated that the purpose of tax treaties was to promote commercial exchanges by eliminating double taxation and that these treaties should not "*help* tax avoidance or evasion [emphasis added]." Since January 28, 2003, paragraph 7 reiterates the purpose of the promotion of commercial exchanges, but it adds that "[I]t is also a purpose of tax conventions to *prevent* tax avoidance and evasion [emphasis added]." The French version of paragraph 7 refers only to the prevention of la fraude et l'évasion fiscale (tax fraud and evasion). It was argued above that the reference to the prevention of tax evasion contained in the preamble of Canadian treaties is of no assistance to the tax authorities in dealing with transactions that abuse treaties because in those cases, the issue is avoidance and not evasion. That statement is true in the Canadian context, and it must be emphasized that the issue raised in that earlier discussion was whether the preamble of Canadian treaties could, for *Canadian* tax purposes, be interpreted as preventing tax avoidance. However, it seems that in some French-speaking countries, the word "évasion" extends to avoidance transactions.[112] Keeping in mind that the word "évasion" found in paragraph 7 of the commentary on article 1 of the model convention probably extends to "évitement" ("avoidance"), as is confirmed by the English version of paragraph 7,[113] there are now grounds to argue that one of the purposes of tax treaties is the prevention of avoidance.

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108 [2000] 4 CTC 159 (FCTD).

109 Ibid., at 179.

110 The first comment on this subject comes from the Federal Court of Appeal in *Cudd Pressure Control Inc. v. The Queen*, 98 DTC 6630, at 6636-37 (FCA) (McDonald JA).

111 Supra note 18.

112 Jean-Marc Déry and David A. Ward, "Canada," in International Fiscal Association, *Interpretation of Double Taxation Conventions*, *Cahiers de droit fiscal international*, vol. 78a (Deventer, the Netherlands: Kluwer Law and Taxation, 1993), 259-89, at 269.

113 As mentioned previously, the English version refers to "tax avoidance and evasion" whereas the French version refers to "la fraude et l'évasion" (fraud and evasion).

Context

The Vienna convention requires that when a treaty or a provision of a treaty is to be interpreted, the context of the treaty or the provision must be taken into account. The context includes the preamble, the text, and annexes, as well as the OECD commentary.[114] On the subject of the preamble, it was argued in the 1999 thesis that the preamble to Canadian treaties does not provide much clarification on the question whether section 245 is consistent with the treaties. The three reasons advanced in support of this claim were explained earlier in this article, under the heading “Preamble to Treaties”: the fact that the preamble refers to “fiscal evasion”; the difficulty of applying a treaty to prevent tax evasion since it does not include any provisions on the basis of which evasion could be attacked; and the presence of the “domestic tax benefit provision,” coupled with the principle that treaties do not levy taxes.[115] Also as mentioned in that earlier discussion, this conclusion remains valid in 2003, except with respect to the Canada-Venezuela treaty, in which the English preamble, with its reference to the “prevention of fiscal avoidance,” could lead to a finding of consistency between GAAR and the treaty.

With respect to the text and the annexes of the Canadian treaties, the 1999 thesis attempted to determine whether a negative inference must be drawn from the fact that the Canadian treaties included anti-abuse measures (for example, the restriction of treaty benefits to beneficial owners of dividends, interest, and royalties) and that only the Canadian treaties with Germany and the United States expressly provide that the contracting states may apply domestic anti-abuse rules.[116] In other words, the 1999 thesis attempted to discover whether the absence of provisions in the other treaties authorizing recourse to domestic anti-abuse rules was to be interpreted as indicating that the latter could not be used or simply that the parties to these treaties considered that it was unnecessary to provide specifically that domestic anti-abuse rules could be applied. It was proposed in the thesis that it was possible to argue, primarily on the basis of the Supreme Court’s ruling in *Stubart Investments Ltd.*,[117] that domestic anti-abuse rules could not be invoked with respect to Canada’s treaties other than those with the United States and Germany. In *Stubart*, the Supreme Court of Canada refused to conclude that there was an *unwritten* anti-abuse rule because of the presence of an anti-abuse measure in the ITA. However, the 1999 thesis indicated that opinion was divided as to what inferences could be drawn from the absence of express provisions allowing recourse to domestic anti-abuse measures.

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114 Goyette, supra note 1, at 55-63. See also John F. Avery Jones, “The Effect of Changes in the OECD Commentaries After a Treaty Is Concluded” (2002) vol. 56, no. 3 *Bulletin for International Fiscal Documentation* 102-9, at 102-3.

115 Goyette, supra note 1, at 56.

116 At the time of the 1999 thesis, the treaty with Germany did not include article 29(6) and the discussion therefore applied only to the treaty with the United States. For simplification purposes, and because article 29(6) is similar to article XXIX A(7) of the Canada-US treaty, the treaty with Germany has been added to the discussion as if it had been considered in 1999.

117 *Stubart Investments Ltd. v. The Queen*, [1984] 1 SCR 536, at 557.

Accordingly, the 1999 conclusion was that the text and the annexes of Canadian treaties, in terms of context, are of no help in determining whether or not domestic anti-abuse rules are consistent with the treaties.[118] This conclusion still holds.

With respect to the OECD commentary, the main conclusion of the 1999 thesis was that it is ambiguous and seems to apply only to abuses involving base companies. The thesis also referred to the fact that in the report on harmful tax competition,[119] the OECD's Committee on Fiscal Affairs had recommended that the commentary be clarified.[120] Giving effect to that recommendation, the OECD commentary on the model convention has been significantly revised; it now provides that states can apply their domestic anti-abuse rules to counter transactions that abuse tax treaties. The commentary refers to two approaches that justify the application of domestic anti-abuse rules to all types of treaty abuse, not only to abuses involving base companies. The first approach corresponds to the "true nature" or "transactional" approach examined above. Under that approach, which has been adopted by many states, an abuse of a treaty is considered to be an abuse of domestic tax law, and a domestic anti-abuse rule is a tool for determining the facts that give rise to tax liability. As a consequence, a domestic anti-abuse rule is neither covered nor affected by a tax treaty; and as a general rule, there will be no conflict between such rules and tax treaties.[121] The second approach described in the revised commentary corresponds to the interpretive approach discussed above. Under that approach, an abuse of a treaty is not an abuse of domestic tax law. However, a proper interpretation of treaties—that is, an interpretation in good faith that takes into account the object and purpose of the treaty—leads to the conclusion that there is no conflict between domestic anti-abuse rules and tax treaties.[122] Regardless of the approach adopted, the commentary suggests, as a guiding principle to the determination of whether a transaction is abusive, an examination of whether the transaction is contrary to the object and purpose of the relevant treaty provisions.[123]

In *Crown Forest*, the Supreme Court of Canada declared that the model convention is an instrument of "high persuasive value"[124] in defining the scope of a treaty, and the court relied heavily on the commentary on the model convention in arriving at its decision.[125] It is therefore to be expected that the new commentary on article 1

118 Goyette, supra note 1, at 56-58.

119 Organisation for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998), 48, 49, and 68.

120 Goyette, supra note 1, at 59-63.

121 Paragraphs 9.2, 22, 22.1, and 22.2 of the commentary on article 1 of the model convention, supra note 18.

122 Ibid., at paragraph 9.3.

123 Ibid., at paragraph 9.5.

124 Supra note 6, at 827.

125 On this topic, see François Vincent, "Crown Forest Industries: The OECD Model Tax Convention as an Interpretative Tool for Canada's Tax Conventions" (1996) vol. 44, no. 1 *Canadian Tax Journal* 38-58, at 55-56.

will have considerable impact when courts are called upon to decide whether a domestic anti-abuse rule such as GAAR is compatible with Canadian tax treaties. However, since the commentary relied upon by the Supreme Court in *Crown Forest* preceded the treaty at issue in that case, one might question the weight that should be given to the new commentary on article 1 in interpreting treaties concluded before the January 2003 revisions. The Committee on Fiscal Affairs has taken the position that a subsequent commentary should be considered in the interpretation of a treaty on the ground that such commentary reflects a consensus between OECD member countries as to the interpretation to be given to existing provisions.[126] Moreover, it appears that a subsequent commentary constitutes a subsequent agreement or practice within the meaning of article 31(3) of the Vienna convention.[127] In the Finnish decision *A Oyj Abp*,[128] the Supreme Administrative Court attached great importance to the OECD commentary subsequent to the tax treaty at issue, while stating that a subsequent commentary should not lend as much weight as a commentary preceding the treaty. Likewise, in *Cudd Pressure*,[129] Canada's Federal Court of Appeal took the position that although the relevance of a subsequent commentary may be questionable, nonetheless such a commentary can provide some assistance in ascertaining the legal context of a treaty; and in fact, in that case, the court took into account the subsequent commentary.[130] However, with respect to the revisions to the commentary on article 1, it must be emphasized that six states do not share the views expressed in the new commentary.[131] Furthermore, the changes made to the commentary are significant. Before the January 2003 revisions, it was difficult to interpret the commentary as permitting the application of domestic anti-abuse measures except in the case of base companies,[132] whereas the revised commentary permits the application of domestic anti-abuse rules to all types of treaty abuse. In light of the extensive changes made to the commentary and of the reservations expressed by certain states with regard to those changes, a court called upon to rule on the consistency between a domestic anti-abuse rule and a treaty may be tempted to embrace the opinion of certain writers that a commentary subsequent to a treaty should not have significant influence in the interpretation process.[133]

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126 See paragraphs 33 to 36.1 of the Introduction to the model convention, supra note 18.

127 Supra note 5. See Goyette, supra note 1. For a contrary opinion, see Lang, supra note 22.

128 *A Oyj Abp*, supra note 22, at 1065.

129 Supra note 110, at 6635.

130 Wilson and Welch, supra note 4, at 6:31.

131 See paragraphs 27.4 to 27.9 of the commentary on article 1 of the model convention, supra note 18. The six states in question are Belgium, Ireland, Luxembourg, the Netherlands, Portugal, and Switzerland.

132 Goyette, supra note 1, at 59-63.

133 Wilson and Welch, supra note 4, at 6:30-31. See also Avery Jones, supra note 114, at 103-9, who indicates that commentaries made subsequent to a treaty will be considered but that the

There are sound arguments in favour of the relevance of a subsequent commentary in the interpretation of a treaty. There are also persuasive arguments in favour of a measure of caution in taking into account a subsequent commentary such as that regarding the consistency of domestic anti-abuse rules and treaties. In such circumstances, it is difficult to speculate as to which arguments would be embraced by a Canadian court called upon to rule on the question. It therefore appears appropriate to conclude this discussion on the context of tax treaties by recalling that, according to the OECD Committee on Fiscal Affairs, taking the context into account in the process of treaty interpretation means that the interpreter must search for a coordinated application of the treaty in order to avoid double taxation or double non-taxation.[134]

Concordance, Symmetry, or Reciprocity

The 1999 thesis concluded that the two approaches—transactional and interpretive—were unsatisfactory because they did not provide a valid answer in all abuse cases. In 2003, it would be risky to use only the transactional (true nature) approach to resolve the question of the consistency of GAAR with treaties, since the need always to respect the purpose of treaties implies that interpretation must be part of the analytical process. Moreover, the comments of the Federal Court of Appeal in *Canadian Pacific*, even if ill-founded, cast doubt on the validity of the transactional approach in Canada. An interpretive approach based on the criteria of the Vienna convention is necessary but entails a degree of uncertainty. For example, the OECD commentary on the model convention has been clarified, but it is not clear how much weight it should be accorded, especially in respect of treaties concluded at a prior date. In addition, the context of Canadian treaties and their provisions varies tremendously from one treaty to another, and international jurisprudence has not yet settled the issue of the application of general anti-abuse rules. Finally, two of the examples examined below deal with states that have expressed their disagreement with the January 2003 revisions to the commentary on article 1 of the model convention. According to these two states, it is not possible to claim, as a general rule, that there is no conflict between domestic anti-abuse rules and tax treaties, or that any such conflict must be resolved in favour of the domestic law. For both states, whether or not a domestic anti-abuse rule may be applied to a transaction involving treaty abuse seems to depend on the nature of the domestic anti-abuse rule in question.[135]

In these circumstances, it appears that the approach proposed in the 1999 thesis to resolve the issue of consistency is still valid. Essentially, that approach is based on the decisive or determining element that emerges from the transactional and

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weight to be granted to them will depend on the circumstances, including the extent of the changes between the former and the new commentary as well as the reasons for a change.

134 *Tax Treaty Override*, supra note 16, at paragraph 19.

135 See paragraphs 27.5 and 27.7 of the commentary on article 1 expressing, respectively, the positions of Ireland and the Netherlands.

interpretive approaches: concordance, symmetry, or reciprocity of treatment by both contracting states. The 1999 thesis proposed to resolve the question of consistency between GAAR and a treaty by interpreting the treaty in a manner that would achieve concordance or symmetry of treatment. As mentioned previously, the task is to determine how each state perceives the transaction in order to bring about a symmetrical application of the treaty based on the true nature of the transaction. Also, this concordant interpretation or symmetry of treatment means that one must search for an interpretation of the treaty that corresponds to that applied by the other state, unless, of course, that interpretation is unreasonable. The 1999 thesis maintained that the proposed approach would ensure compliance with the two traditional approaches (transactional and interpretive). That argument is reiterated in this article, particularly since it appears to find support in the work of the OECD Committee on Fiscal Affairs, as well as in recent literature, which emphasizes that without a certain reciprocity, an imbalance in the application of treaties would result.[136] This article does, however, reflect a change in position from that expressed in 1999, with respect to the application of this concordant or symmetrical approach in various situations. The following discussion illustrates in what respect the 1999 position has changed.

The 1999 thesis compared two situations of treaty abuse. The first situation concerned surplus stripping similar to that found in *RMM Canadian Enterprises*.[137] A US resident shareholder, in order to avoid a deemed dividend on the windup of his Canadian corporation, transferred his shares in the latter to another corporation that he controlled. The purpose of this transfer was to realize a non-taxable capital gain in Canada in accordance with the Canada-US treaty. The second situation involved a Canadian financial institution that subscribed for preferred shares in an Irish affiliate and attempted to deduct the dividends received from that affiliate in calculating its Canadian income, invoking ITA paragraph 113(1)(a) on the basis that the dividends derived from exempt surplus of the affiliate. The minister of national revenue, on the basis of ITA paragraph 258(3)(a) or, in the case of perpetual preferred shares, ITA section 245, treated the amounts received from the Irish affiliate as interest taxable in Canada.

In the first scenario, the 1999 thesis maintained that the search for a concordant interpretation leads to the conclusion that GAAR is consistent with the tax treaty since the United States considers that the transaction undertaken by the taxpayer is a surplus strip. In addition, the application of GAAR in such a case acknowledges the true nature of the transaction undertaken—surplus stripping. It also corresponds to the three possible purposes of a treaty: the allocation of taxing powers between states, the prevention of double taxation, and the prevention of tax avoidance (assuming that the line of jurisprudence that attributes such a purpose to treaties continues).

136 Wilson and Welch, supra note 4, at 6:62.

137 Supra note 3.

This conclusion is still valid in 2003, and it gains further support from the OECD report on the application of the model convention to partnerships. In that report, the Committee on Fiscal Affairs examined the question whether a state ("the source state") must grant the benefit of its treaty to the partners in a partnership that has derived income from its jurisdiction.[138] Under its domestic legislation, the source state considers the partnership to be a transparent entity—that is, a non-taxable entity—and, as a consequence, not to be a "resident" for purposes of a treaty. According to the committee, to the extent that the partners' state of residence also applies the regime of fiscal transparency to the partnership and thus taxes partners on the income derived by the partnership, it is logical for the source state to grant the partners the benefit of the treaty that it has entered into with the partners' state of residence. However, in cases where the partners' state of residence treats the partnership as a taxable entity (and therefore does not tax the partners), the committee considers that the source state should not grant the partners the benefit of the provisions of the treaty it has entered into with that state. The committee notes:

> In these latter circumstances, the underlying factual premise on which the allocation of taxing rights is based, that is, that the source State is only obliged to reduce its domestic law tax claim where the income in question is potentially liable to tax in the hands of a resident of the treaty partner, is simply not present.[139]

The committee therefore recommends that, in applying the convention to partnerships, the source state should take into account, as part of the factual context in which the treaty is to be applied, the treatment of an item of income arising in its jurisdiction by the state of the taxpayer claiming the benefits of the treaty as a resident. The committee considers that such an approach reflects the fundamental objectives of the treaty, which are "to eliminate double taxation and prevent double non-taxation."[140] In my view, the approach proposed by the OECD Committee on Fiscal Affairs to a source state that is seeking to apply a tax treaty to a partnership corresponds to the symmetry of treatment proposed in 1999 and reiterated in this article as a way of resolving the question of consistency between domestic anti-abuse rules and tax treaties.

In the second example, involving a Canadian financial institution that subscribed for preferred shares of an Irish affiliate, the 1999 thesis maintained that the search for concordance led to the opposite conclusion: section 245 (or paragraph 258(3)(a))

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138 Organisation for Economic Co-operation and Development, *The Application of the OECD Model Tax Convention to Partnerships*, Issues in International Taxation no. 6 (Paris: OECD, 1999), paragraphs 47 to 56. The conclusions of this report have been incorporated in the commentary on the model convention as explained in paragraph 2 of the commentary on article 1, supra note 18.

139 Ibid., at paragraph 53.

140 Ibid., at paragraph 52.

is inconsistent with the tax treaty. The application of a Canadian anti-abuse measure in such a scenario is not consistent with the allocation of taxing powers (since Ireland has the jurisdiction to tax profits and the treaty provides that the paragraph 113(1)(a) deduction must be applied even to dividends from profits subject to preferred treatment in Ireland) or with the prevention of double taxation (since Canada would be taxing profits already taxed in Ireland).

If the facts remain as described in the 1999 thesis, the conclusion of inconsistency between GAAR (or paragraph 258(3)(a)) and treaties remains valid in 2003. However, if it were to be established that in fact Ireland (or another country if the transaction involved an affiliate in another country) recharacterized the preferred share investment as debt and granted a tax deduction to the affiliate when it paid the dividends to the Canadian company, the conclusion regarding the consistency between the Canadian anti-abuse measures and the treaty would be opposite to that of 1999. Indeed, given such facts, a concordant interpretation would be one that acknowledged that the transaction is one of debt and not a share investment. This interpretation would reflect the true nature of the transaction. It would also reflect the context of treaties to the extent that, as expressed by the OECD's Committee on Fiscal Affairs, the context requires a coordinated application of the treaty so as to avoid double taxation (since the interest paid by the affiliate would give rise to entitlement to a deduction in the calculation of income) or double non-taxation (which would arise if Canada did not apply any anti-abuse measure, since the amount paid to the Canadian company would be deducted by the affiliate and would not be taxed in Canada).

In seeking symmetry of treatment in this case of investment in Ireland in order to determine whether there is consistency between GAAR and the Canada-Ireland treaty, there is respect not only for the true nature of the transaction but also for the context of the treaty in question. Moreover, this approach corresponds to that recommended by the OECD Committee on Fiscal Affairs in situations where there is a conflict of qualification—that is, cases in which the state of residence and the state of source apply different articles of the treaty on the basis of differences in their domestic law.[141] The Committee on Fiscal Affairs is of the view that, in such cases, the manner in which the state of residence eliminates double taxation depends, to some extent, on how the treaty has been applied by the source state. The committee's position is based on article 23 of the model convention, which provides that relief is to be granted, whether by exemption or by credit, to items of income that are otherwise taxable "in accordance with the provisions of the Convention."[142]

141 *The Application of the OECD Model Tax Convention to Partnerships*, supra note 138, at paragraphs 93 to 123. See also paragraphs 32.1 to 32.7 of the commentary on articles 23A and 23B of the model convention, supra note 18.

142 Paragraph 2 of article XIV of the Canada-Ireland treaty also provides that Canada shall grant a credit for tax paid in Ireland "in accordance with this Agreement" (An Agreement Between the Government of Canada and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Ottawa on November 23, 1966). However, unlike other Canadian treaties, the Canada-Ireland treaty does

Therefore, according to the Committee on Fiscal Affairs, the source state characterizes an item in a certain way, and to the extent that such a characterization is made in accordance with the provisions of the treaty, the state of residence is required to respect it when that state eliminates double taxation. In the example of investment in Ireland, the approach recommended by the OECD means that Canada should take into account the characterization of the investment by the Irish government in determining whether double taxation has been eliminated (and if so, to what extent). This approach is analogous to that which must be taken when symmetrical treatment is being sought in determining whether or not a domestic anti-abuse rule can be applied in a case of treaty abuse. Is it thus possible to see in the OECD's position a recognition of the symmetrical treatment recommended in 1999 and reiterated in this article?

The position expressed by the OECD that the state of residence is required to respect the manner in which the source state characterizes an item of income pertains to the application of a tax treaty to a partnership. Therefore, it is not directed to the issue of treaty abuse. The OECD's new position, or at least its clarified position, is that domestic anti-abuse rules are consistent with tax treaties; however, the commentary that expresses this new position does not set as a condition for the application of domestic anti-abuse rules the requirement to take into account how the other state has treated the transaction. In this context, there is reason to doubt that the OECD would conclude that a state of residence that considers that there has been an abuse of its treaty with the source state should nonetheless be required to respect the characterization given to an item of income by the source state when the application of a domestic anti-abuse rule characterizes the item in question otherwise. Accordingly, the position taken by the OECD in its report on partnerships should not be interpreted as an endorsement of the symmetrical approach proposed in 1999 and reiterated in the present article.

That said, it is important to emphasize that Ireland has made observations on the new OECD commentary regarding the application of domestic anti-abuse rules in cases of treaty abuse. Specifically, Ireland has expressed its disagreement with the general conclusion in the new commentary to the effect that there is no conflict between domestic anti-abuse rules and treaties, or that any such conflict must be resolved in favour of the domestic law. According to Ireland, the possibility of applying a domestic anti-abuse rule to a transaction that abuses a treaty "will depend on the nature of the domestic law provision and also on the legal and constitutional relationship in individual member countries between domestic law and international agreements and law."[143] The symmetry of treatment approach clearly respects the legal relationship between Canadian and Irish domestic law and the

not contain any specific provisions with respect to the elimination of double taxation regarding dividends arising from the exempt surplus of a foreign corporation. On this subject, see Goyette, supra note 1, at 43-44.

143 Paragraph 27.5 of the commentary on article 1, paragraph 40.3 of the commentary on article 7, and paragraph 68.2 of the commentary on article 10 of the model convention, supra note 18.

Canada-Ireland treaty, since the cornerstone of this approach consists in taking into account the true nature of the transaction under the domestic law of each contracting state,[144] in order to ensure that the treaty will be applied in a coordinated manner—that is, a manner that avoids double taxation as well as double non-taxation. Accordingly, even in the absence of endorsement by the OECD, the search for symmetrical treatment should be favoured when it is necessary to determine whether a domestic anti-abuse rule is consistent with a treaty. Applied with flexibility and objectivity, this symmetrical treatment approach can yield suitable results even in "borderline cases," as shown by the revised application of this method to the "borderline case" described in the 1999 thesis.

This "borderline" case is in fact a variation of the classic situation of "treaty shopping"[145] through which a Dutch company is interposed in order to benefit from the treaty between Canada and the Netherlands.[146] In this example, a Bahamian company wanted to loan money to a Canadian company, but a direct loan would have given rise to part XIII tax of 25 percent on the interest. Consequently, the Bahamian company incorporated a company in the Netherlands (Dutchco), which loaned money to the Canadian company. The transaction was structured so that very little tax would be paid in the Netherlands and withholding tax would be avoided when the money was returned to the Bahamas.[147]

The 1999 thesis concluded that the search for concordance meant that GAAR could not be invoked in this situation. That conclusion was based primarily on the following factors:

- the Netherlands considers that Dutchco is resident in that country and is entitled to the benefits of the treaty with Canada;
- the Netherlands treats the amounts received by Dutchco as taxable interest, and thus Canada also must consider that the Canadian company paid interest to Dutchco; and
- the objective intention of the contracting states is that domestic anti-abuse rules are not applicable to abuses of the Canada-Netherlands treaty.

A re-examination of this scenario, or a more flexible and objective application of the search for symmetry of treatment, calls for a different conclusion.

First, it should be noted that in a number of situations similar to that of Dutchco, an argument can be made that a company like Dutchco is not the beneficial owner

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144 This does not mean that the transaction must receive the same tax treatment in both countries.

145 In *Crown Forest*, supra note 6, the Supreme Court translated "treaty shopping" by "course aux traités."

146 Convention Between Canada and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at The Hague on May 27, 1986, as amended by protocols signed on March 4, 1993, and August 25, 1997.

147 Goyette, supra note 1, at 27-28 and 70-71.

of the interest; and, on the basis of the facts, this argument could satisfy a court that there is no ground for granting the reduction in withholding tax provided for by the treaty. Article 11(2) of the Canada-Netherlands treaty provides for a reduction in the rate of withholding tax imposed by the source state (in this case Canada), but only to the extent that the person who claims this reduced rate is the "beneficial owner" of the interest. In Canadian law, the Supreme Court of Canada has referred to the following reasoning with respect to the meaning of the expression "beneficial owner":

> It seems to me that the plain ordinary meaning of the expression "beneficial owner" is the real or true owner of the property. The property may be registered in another name or held in trust for the real owner, but the "beneficial owner" is the one who can ultimately exercise the rights of ownership in the property.[148]

Moreover, although the Dutch legislation on the meaning of the term "beneficial owner" is not altogether consistent, one can find in the comments of the deputy minister of finance and in a decision by the Hoge Raad, the highest judicial body in the Netherlands, indications that the Canada-Netherlands treaty applies only to the beneficial owner of income such as dividends or interest—that is, the person who can profit freely from the dividends or interest.[149] In addition, the revised OECD commentary on articles 10, 11, and 12 of the model convention states that

> [t]he term 'beneficial owner' is not used in a narrow technical sense[;] rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

The revised commentary adds that it would be contrary to the purpose and the object of the treaty for the source state (such as Canada in the Dutchco example) to grant a reduction of tax to a resident of a contracting state who acts as an agent, a nominee, or a simple intermediary for another person who in fact receives the benefit of the income in question.[150] It follows that if the facts demonstrate that Dutchco is merely an agent or conduit, or that it cannot profit freely from the interest paid by the Canadian company, a court will likely conclude that Dutchco is not the beneficial owner of the interest and is therefore not entitled to the reduced rate of withholding tax provided for by the Canada-Netherlands treaty.

Second, with respect to the 1999 conclusion that the Netherlands considers Dutchco to be a resident of that country, it must be acknowledged that the question

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148 *Covert et al. v. Minister of Finance (N.S.)*, [1980] 2 SCR 774, at 784, quoting Hart J in *JC MacKeen Estate v. Min. of Finance (NS)*, [1977] CTC 230, at 247 (NSSCTD).

149 Van Weeghel, supra note 24, at 74-77.

150 See paragraphs 12 and 12.1 of the commentary on article 10, paragraphs 8 and 8.1 of the commentary on article 11, and paragraphs 4 and 4.1 of the commentary on article 12 of the model convention, supra note 18.

whether Dutchco is a resident of the Netherlands is first and foremost a matter of Dutch law.[151] However, a closer analysis of similar cases reveals that the Dutch tax authorities are not altogether convinced that a company in Dutchco's situation is a resident of the Netherlands. Some Dutch tax officials are willing to admit that they use a fictional notion of the word "residence" since, in most cases, companies like Dutchco have their "mind and management" in another country and, at the local level, the only presence is that of a Dutch tax official who takes care of the administrative formalities. In some cases, the Dutch company is in reality only a file in the filing cabinet of a Dutch trust company that administers hundreds of companies like Dutchco, for a fee. In such circumstances, can it be claimed *objectively* that the contracting states—that is, the Netherlands and Canada—wished to protect companies like Dutchco when they entered into an agreement that restricts their taxing powers with respect to residents of the other state?

It is true that the Netherlands will acknowledge that Dutchco received interest and that symmetry of treatment requires that Canada also consider that interest has been paid. However, this should not preclude a finding that Dutchco is not a "resident" of the Netherlands, within the meaning of the Canada-Netherlands treaty, that receives interest, particularly since the Netherlands itself is not convinced of the residence of Dutchco. The question then arises of the intention of the contracting states and the object of the treaty. The 1999 thesis referred to the objective intention of the contracting states; in fact, however, it was the subjective intention that was examined, since it was suggested that the Netherlands, a country known for the favourable tax treatment that it grants to holding companies, never intended that domestic anti-abuse rules would apply to its treaties. Objectively, can it be said that the two states that signed the treaty from which Dutchco hopes to benefit really wanted such a company to benefit? There is good reason to doubt this.

Even if it must be recognized that the treaty was signed with a country that is noted for the favourable tax treatment that it grants to holding companies, it must not be forgotten that the Netherlands itself uses its own domestic anti-abuse rule, the fraus legis, to attack transactions that abuse its treaties or quasi-treaties.[152] Moreover, the Netherlands has expressed its disagreement with the recent OECD commentary, which now recognizes that states may apply their domestic anti-abuse rules in cases of treaty abuse. However, the Netherlands has not taken the position that states can never apply domestic anti-abuse rules to combat treaty abuse. Rather, it has suggested that the possibility of applying domestic anti-abuse rules depends, among other things, on the nature of the domestic rule; and it has recognized that the application of these rules may be justified in cases of "clearly unintended use."[153] Again, can it be argued objectively that the use that Dutchco is

151 See article 4 of the Canada-Netherlands treaty, supra note 146.

152 Van Weeghel, supra note 24, at 145 and 172-75.

153 Paragraph 27.7 of the commentary on article 1 of the model convention, supra note 18.

attempting to make of the Canada-Netherlands treaty is a use intended by the contracting states?

CONCLUSION

In conclusion, concordant or symmetrical interpretation[154] is the element that emerges from both approaches—transactional and interpretive—traditionally used to determine whether a domestic anti-abuse measure is consistent with a treaty. Moreover, concordant interpretation leads to a result that corresponds to that obtained by applying both traditional approaches, and it is a useful adjunct to the OECD commentaries and the presumption against treaty shopping set out in *Crown Forest*.

This re-examination of general anti-abuse rules applicable to treaties and the interaction between tax treaties and GAAR has led to conclusions different from those reached in the 1999 thesis. This result is not surprising given that taxation is a field that is continuously evolving and that the issue of treaty abuse has not yet generated an entrenched jurisprudence, either in Canada or internationally. In this context, it will certainly be worthwhile, at a future time, to return to the issue of treaty abuse and to examine whether jurisprudential or doctrinal evolution supports the opinions expressed in this article.

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154 Or the search for reciprocity—the term used is not important.