COMPARATIVE ANALYSIS OF TREATY ANTI-ABUSE PROVISIONS

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DOMESTIC ANTI-ABUSE APPROACHES: UNITED STATES

- Economic Substance (now also codified)
- Beneficial ownership and the anti-conduit regulations
- Section 267A and its regulations (the new Hybrid rules)
- Judicial doctrines
DOMESTIC ANTI-ABUSE PROVISIONS: CANADA

- **General Anti-avoidance Rule (GAAR) – 245 ITA:**
  - Three-Part Test:
    - (1) a tax benefit,
    - (2) an avoidance transaction (no *bona fide* reason for the restructuring other than to obtain a tax benefit), and
    - (3) the avoidance transaction was abusive.
  - First step: identify the object, spirit and purpose of the relevant rule;
  - Second step: determine whether the avoidance transaction falls within, or frustrates, that rationale.
- Applies to “any benefit” provided under a tax treaty that misuses or abuses a provision of a tax treaty (art. 4.1 of *Income Tax Conventions Interpretations Act* – GAAR applies notwithstanding the treaty).
- Not a “business purpose” or “economic substance” doctrine
**DOMESTIC ANTI-ABUSE PROVISIONS: CANADA**

**MIL Investments (SA) v. The Queen, 2007 FCA 236**

- **Facts**
  - MIL was resident of Cayman Islands and wholly owned by a resident of Monaco.
  - MLI owned DFR - a Canadian mining company the value of which was attributable immovable property in Canada. Normally, the sale of the DFR shares would be taxable in Canada.
  - To avoid Canadian tax, MIL reduced interest in DFR from 11.9% to <10% and continued into Luxembourg. Then the MIL shares were sold but exempt from tax under Canada-Lux treaty due to the <10% share ownership.

- **Decision**
  - GAAR does not apply because none of the transactions abused the treaty as a whole or a specific provision.
  - Tax-motivated treaty shopping was not contrary to the object and purpose of the treaty provision relied upon.
  - The purpose of the treaty was not to prevent “treaty-shopping”.
DOMESTIC ANTI-ABUSE PROVISIONS: CANADA

Alta Energy Luxembourg SARL v R., 2018 TCC 152

- **Facts**
  - Alta Canada's shares were "taxable Canadian property".
  - Sale by Luxco to Chevron generated a $380M gain which was claimed exempt from Canadian tax under the Canada-Luxembourg treaty under the property used in a business exemption.
  - Sale was also tax exempt in Luxembourg.

- **Holding**
  - GAAR did not apply as treaty shopping is not in itself abusive even if it results in double non-taxation.
  - It is not the purpose of the treaty to prevent "treaty-shopping", "conduit arrangements", or double non-taxation, absent a specific provision.
Examples of other domestic anti-abuse provisions:

- Sham doctrine (e.g. *Antle v. The Queen*, 2009 TCC 465)
- Anti-conduit rules for back-to-back loan arrangements, back-to-back royalty payments and shareholder loans (includes character substitution rules)
- Cross-border securities lending arrangements
- Standby charges and guarantee fees, deemed payment of interest
DOMESTIC ANTI-ABUSE PROVISIONS: MEXICO

• Local SAAR enacted in 2008 – “Sham transaction for tax purposes”

• Attempt to include local GAAR in 2014 major tax reform / Courts apply more general civil law principles (fraus legis, economic substance over form and simulation).

  Example: Unefon-Nortel case / Tax authority can re-characterize a related party operation based on economic substance.

• Case law precedents where treaty benefits applicable to business profits are denied based on an inappropriate application of domestic law to define “business profits”.

DOMESTIC ANTI-ABUSE PROVISIONS: MEXICO

Transfer of collection rights
US$325MM

Payment of consideration
US$107MM

Note for US$325MM
DOMESTIC ANTI-ABUSE PROVISIONS: MEXICO

- Domestic preferential 4.9% withholding rate upon interest payments performed by financial institutions or by Multiple Purpose Financial Entity (SOFOM) to foreign taxpayers. Sometimes this rate is even more beneficial than the tax treaty rate for interest.

1. Anti-abuse provision restricts domestic preferential rate when there is a link between the payer and the effective beneficiary of more than 5% of the total interest. There is a link whenever:
   • The effective beneficiary directly or indirectly (including related parties) owns more than 10% of the voting stock of the payer; or
   • Effective beneficiary owns directly or indirectly (including related parties) more than 20% of the stocks.

2. The tax authorities issued a general statement (64/ISR/N) resolving that the restriction was extensive to loan operations, certificates and any other credit operations.
“Beneficial ownership” test for Art. 10 (dividends), Art. 11 (interest) and Art. 12 (royalties) :

- e.g. Velcro Canada Inc. v. The Queen, 2012 TCC 57, Prevost Car Inc. v. The Queen, 2009 FCA 57, aff`g 2008 TCC 231: a restrictive interpretation; based on common law principles and the OECD commentary. Focus on certainty and stability.

- Purpose tests: e.g. article 10(8), 11(9) and 12(8) of the Canada-UK Treaty

- Detailed LOB provisions: e.g. Art. XXIX A of the Canada-US treaty

- Explicit “anti-abuse” provisions: e.g. Art. XXIX A(7) of the Canada-US treaty, article 29(6) of Canada-Germany
TREATY ANTI-ABUSE PROVISIONS: MULTILATERAL INSTRUMENT (MLI)

• Action 15 of OECD BEPS – a single instrument to address treaty-related BEPS measures

• Signed: June 7, 2017
  • 87 countries have signed & 6 have given notice of intention to sign

• Coming into force: July 1, 2018 (5 countries have ratified)

• Coming into effect: once Canada deposits instrument of ratification
  • Canada: Bill C-82 tabled June 20, 2018 – was sent for 3d reading
  • for WHT, on 1st day of third month after deposit
  • for other taxes, 1st tax year beginning 6 months after the deposit
Art. 6 MLI: Purpose of a CTA

- **Include in preamble:** “purpose of tax treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through avoidance and evasion (including treaty-shopping arrangements aimed at obtaining ... [treaty benefits for] residents of third jurisdictions)”

- Tax treaties interpreted in their context and in light of their object and purpose – preamble will guide interpretation
  - Relevant for PPT and GAAR
Art. 7 MLI: PPT/LOB/SLOB

- Anti-avoidance rules to prevent benefits being used in unintended circumstances (treaty-shopping and other abusive arrangements)
- One of three provisions to curb treaty abuse
  - Principal Purpose Test (PPT)
  - PPT + Simplified LOB (SLOB)
  - Detailed LOB supplemented by an anti-conduit rule
Art. 7 MLI: PPT/LOB/SLOB

- PPT

- Comprehensive LOB – more detailed/objective (safe harbor)
  - Article XXIX-A of the Canada-US Treaty
  - Requires anti-conduit rules (e.g. anti-hybrid rules)

- PPT with Simplified LOB (SLOB)
  - Combines uncertainty under PPT with complexity of LOB
Art. 7 MLI: PPT

A benefit under the CTA shall not be granted in respect of an item of income or capital if it is reasonable to conclude; having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the CTA.
• Canada: PPT / LOB
  • PPT as an interim measure.
  • In the future, Canada intends to adopt a LOB provision, in addition to or in replacement of the PPT, whenever it renegotiates a bilateral tax treaty.

• Mexico: Simplified LOB + PPT
  • Expects mostly to use the PPT

• U.S.:
  • Uses its own LOB clause in Tax Treaties (several exceptions still remain)
  • Is not a party to the MLI
  • U.S. Model Tax Treaty 2016
Mexico:

- More likely that tax authorities will continue to base position on existing arguments
- PPT likely to be used only as last resort
- Subjectivity of the test could work in favor of, and against, tax administration
TREATY ANTI-ABUSE PROVISIONS: MLI - POSITION OF TAX AUTHORITIES

Canada - IFA 2018 Conference- Q2 (2018-0749181C6) – OECD Examples:

• Since Canada has not placed reservation on Article 29 of OECD Model – examples could provide guidance

• Also look at:
  • facts and circumstances,
  • relevant Canadian law,
  • jurisprudence
  • wording, object and purpose of the CTA

• CRA will provide advance income tax rulings
TREATY ANTI-ABUSE PROVISIONS: MLI - POSITION OF TAX AUTHORITIES

Canada - IFA Conference- Q2 (2018-0749181C6) Private Equity/Collective Funds (CIVs):

• Application of the PPT is fact specific

• Will allow access to treaty benefits unless the treaty benefit accessed through the CIV could not have be accessed by the investors directly

• CRA will take into account past agreements/ rulings:
  • AITRs – Luxembourg fonds commun de placement, Switzerland contractual investment funds, Ireland common contractual funds
  • Competent Authority Agreements: e.g. Canada-Netherlands agreement re. closed funds for mutual account
  • Tax Treaties: Para 7(a) of Art.29 Canada-France; Para. 7(b) & (c) Art. 10 Canada-US
Canada – Ordering Rules:

- **Implementing Act and MLI prevail over Canadian law**
- **Income Tax Convention Interpretation Act prevails over MLI**
  - Section 4.1: states that section 245 ITA applies to any benefit provided under a treaty (notwithstanding the treaty or the Implementing Act)
- **CTF 2017 Annual Conference- Q8 (2017-0724151C6):** PPT and GAAR could apply as alternative assessing positions directed at a given transaction or position
- **Specific treaty anti-avoidance rule (e.g. dividends) prevails over PPT?**
  - Does the rule apply?
  - Does it address the transaction?
### TREATY ANTI-ABUSE PROVISIONS: MLI - DIFFERENCES BETWEEN THE PPT AND GAAR

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<td>Tax Benefit</td>
<td>Same</td>
<td>Same</td>
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<td>Avoidance Transaction</td>
<td>one of the principal purposes test</td>
<td>Primary purpose test (not primarily for bona fide purposes)</td>
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<td>Abuse or Misuse of the Treaty</td>
<td>onus on the taxpayer to establish that a treaty benefit is in accordance with the object and purpose of the treaty</td>
<td>(per SCC) onus is on the Government to establish that an avoidance transaction is contrary to the object, spirit and purpose of the relevant provisions of the treaty</td>
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ADVISING CLIENTS – REAL CHANGES OR BUSINESS AS USUAL?

- United States
- Canada
- Mexico
QUESTIONS?