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-- Vern Krishna ... -- Capital mobility promotes economic development and international trade; however, business globalization also has tax consequences for multinational enterprises and national treasuries. Hence, countries enter into bilateral income tax treaties to prevent double taxation and tax evasion. ... -- Tax treaties prevent—or at least minimize—the risk of double taxation by allocating taxing jurisdiction between the treaty partners. Multinational enterprises use tax treaties to eliminate double taxation but are also interested in improving their profits through efficient corporate structures that enhance after-tax returns on equity. ... -- Also referred to as double tax agreements (DTAs). ... -- Preventing fiscal

Using Beneficial Ownership to Prevent Treaty Shopping

Date: November 16, 2009

Vern Krishna

Capital mobility promotes economic development and international trade; however, business globalization also has tax consequences for multinational enterprises and national treasuries. Hence, countries enter into bilateral income tax treaties to prevent double taxation and tax evasion.

Tax treaties[1] prevent—or at least minimize—the risk of double taxation by allocating taxing jurisdiction between the treaty partners. Multinational enterprises use tax treaties to eliminate double taxation but are also interested in improving their profits through efficient corporate structures that enhance after-tax returns on equity.

Preventing fiscal evasion is more difficult. Evasion is subject to considerable linguistic confusion in international tax law. For example, in English the term “tax evasion” usually means fraud of a criminal nature.[2] In French, however, evasion means avoidance, which under most fiscal systems is entirely proper and legal. Swiss domestic law defines fraud more narrowly to mean “forged, falsified or substantially inaccurate documents.” Hence, Switzerland’s secretive banking system attracts money from around the world. The U.S. IRS’s request that UBS AG reveal the identity of its American depositors hit a brick wall.[3]

However, the confusion is not confined to linguistic nuances. The U.S. also uses the term “evasion” carelessly. For example, section 482 of the Internal Revenue Code, which deals with the allocation of income and deductions among taxpayers, states:

> In any case of two or more … businesses … owned or controlled directly or indirectly by the same interests, the Secretary may … allocate gross income … if he determines that such … allocation is necessary in order to prevent *evasion* of taxes. [Emphasis added.]

The actual purpose of the provision is to prevent tax avoidance, not evasion.
In contrast, tax avoidance is a legitimate form of tax planning that most sophisticated legal regimes accept. In the United States, Judge Learned Hand articulated the principle succinctly in *Heivering v. Gregory*:[4]

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.

In the United Kingdom, Lord Tomlin gave us the *Westminster* principle:

> Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it would otherwise be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.[5]

The principle survives to this day and has been endorsed repeatedly by the highest courts.[6]

Treaty shopping can significantly improve an entity's return on equity. The *International Tax Glossary* defines treaty shopping as "a situation where a person who is not entitled to the benefits of a tax treaty makes use—in the widest sense of the word—of an individual or of a legal person in order to obtain those treaty benefits that are not available directly."[7]

Typically, treaty shopping occurs when a multinational enterprise interposes an entity—usually a corporation—in a third country to take advantage of the terms of a favorable provision in the country's treaty that would not be otherwise available to the multinational enterprise if it is structured through a more direct route between two countries. Treaty shopping can reduce withholding taxes, recharacterize income to exempt otherwise taxable income, and result in double nontaxation of income. Thus, treaty shopping allows one to do indirectly what a particular treaty may not permit directly.

There are various mechanisms—some broad, others specific—to curtail treaty shopping. The most common methods are:

- broad rules that deny all treaty benefits to persons who are not bona fide residents of the treaty country;
- antiabuse rules that target specific forms of income—typically dividends, interest, and royalties;
- specific and detailed limitation on benefits provisions; and
- domestic antiabuse rules—such as general anti-avoidance rules.

The problem with most treaty shopping structures is not their legitimacy in the sense of tax evasion, but their appropriateness in the context of legitimate tax minimization or avoidance. Who should be entitled to the benefits of a bilateral treaty? Generally, only the residents—and in some cases, nationals and citizens—of a contracting state that is a party to a treaty should derive benefits from the treaty. What happens if the taxpayer interposes an entity that becomes resident in the particular country solely for the purpose of benefiting from its provisions? Unless a treaty otherwise provides, such avoidance may or may not be appropriate. The answer varies among countries.

Treaty shopping refers to the use of a treaty by persons who may not ordinarily come within the personal scope article of the particular treaty. Treaty shopping pits the *Westminster* and *Helvering* doctrines—which espouse the legitimacy of tax avoidance—against the underlying basic structure of bilaterally negotiated tax treaties. Tax treaties are bilateral agreements that should reflect the intention of the parties by specifying who should derive benefits from the particular treaty. Absent clear language in the treaty or domestic legislation, taxpayers will—and are entitled to—arrange their financial affairs to maximize their after-tax returns on equity.

I. Personal Scope of Treaties

The personal scope article of treaties, usually restricts benefits to the residents of one or both of the partners of the particular treaty. For example, Article I of both the OECD and U.N. model conventions states:

> This Convention shall apply to persons who are residents of one or both of the Contracting States.

Similarly, with some exceptions, the U.S. model convention also limits the scope of U.S. treaties to residents of one or both of the contracting states.

A. Definition of Person

Article III of the OECD and U.N. models state that the term "person" includes an individual, a company, or any other body of persons. Clearly, this is not an exhaustive definition and can include other groups or entities. Thus, "person" includes unincorporated entities that are treated as a body corporate for tax purposes.[8] For example, a foundation (stiftung) may be a person for treaty purposes.

The U.S. model treaty has a longer list of inclusions in its definition of person. Article III (l)(a) states that a person includes an individual, an estate, a trust, a partnership, a company, and any other body of persons. Hence, most U.S. treaties expressly define person to include individuals, corporations, partnerships, and trusts. Article III (l)(e) of the Canada-US. treaty is an exception. Although it does not specifically mention partnerships, it does refer to “any other body of persons.”

For the purposes of treaty interpretation of undefined terms, one refers to the law of the taxing state.[9] Section 7701(a)(1) of the IRC defines the person to include an individual, a trust, estate, partnership, association, company, or corporation.[10] The phrase “body of persons” would appear to be broad enough to include partnerships to the extent that partnerships are not treated wholly as conduits. When domestic law treats a partnership wholly as a conduit, the issue loses significance, as the members of the partnership are entitled to the benefits of the treaty.

The domestic rules of the other OECD member countries differ substantially regarding the treatment of partnerships. Some countries treat partnerships as taxable units (sometimes even as companies), whereas other countries disregard the partnership entity and treat it is a pure conduit for the partners. Hence, the OECD commentary is necessarily vague:

> Where a partnership is treated as a company or taxed in the same way, it may be reasonably argued that the partnership is a resident of the Contracting State taxing the partnership…. In other instances … the application of the Convention to the partnership as such might be refused, at least if no special rule covering partnerships is provided for in the Convention.

B. Deemed Residence

Many countries deem a company to be resident in the country if it is incorporated therein. Canada, for example, deems a company that is incorporated in Canada to be a domestic corporation.[11]

Article 4 of both the OECD and U.N. model conventions define the term “resident of a contracting state” to mean “any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature.” Hence, for example, a foreign person may be eligible for tax treaty benefits merely by forming a corporation (or similar entity) in Canada to bring itself within the personal scope of a Canadian bilateral tax treaty.

II. The Nature of Treaty Shopping

Treaty shopping refers to the use of a treaty by persons that might not ordinarily come within its scope to avoid taxes. The objective is to reduce source taxation—typically on dividends, interest, royalties, and business income not connected to a permanent establishment. For example, a taxpayer’s country of residence (R) may not have a tax treaty with the country from which it derives income (S). Income from S to R might be subject to high withholding rates of 25 percent to 30 percent. In these circumstances, the taxpayer (the treaty shopper) may shop for a treaty with a third country (T) and set up residence in T by incorporating a company (Holdco) to obtain treaty benefits between R and T. Holdco would invest in S and receive investment income. If S has a favorable treaty with T that reduces withholding taxes to 5 percent and T does not tax the investment income (or taxes it at very low rate), the taxpayer will improve its net return on equity in its country of residence (R).

A. OECD Model Convention

The OECD is concerned about international capital flows and the matter of treaty shopping. Its commentary on Article I states:[12]

> 7. The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion.
>
> 7.1. Taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries’ laws. Such attempts may be countered by provisions or jurisprudential rules that are

> part of the domestic law of the State concerned. Such a State is then unlikely to agree to provisions of bilateral double taxation conventions that would have the effect of allowing abusive transactions that would otherwise be prevented by the provisions and rules of this kind contained in its domestic law. Also, it will not wish to apply its bilateral conventions in a way that would have that effect.

The OECD recognizes that the extension of double taxation conventions increases the risk of abuse by facilitating the use of artificial legal constructions aimed at securing the benefits of both the tax advantages available under some domestic laws and the relief from tax provided for in double taxation conventions.[13] The OECD identifies two ways in which contracting states can address the issue of treaty shopping:[14]

> States may take the position that an abuse of the provisions of a treaty could also be characterized as an abuse of the provisions of domestic law.[15] If so, the States must then determine whether the provisions of the applicable tax conventions operate to prevent the application of any anti-avoidance rules in the domestic law.
>
> Alternatively, States may take the position that treaty shopping is an abuse of a treaty in itself, as opposed to an abuse of domestic law, and that a proper interpretation of taxing conventions allows States to disregard abusive transactions.

The OECD recommends that member states adopt specific provisions that address abusive transactions.[16] Further, member states can recognize domestic anti-avoidance provisions, such as a general antiavoidance rule, in their bilateral tax treaties.[17]

Most treaties reduce the withholding tax on dividends, interest, and royalties only if the payee is a nonresident who *beneficially owns* the right of payment. “Beneficial ownership” is, in effect, a specific anti-avoidance concept to prevent treaty shopping through conduit entities.

Countries use various broad concepts—such as anti-treaty-shopping,[18] antiabuse, substance over form, and the GAAR—to prevent abusive tax avoidance. Some of these concepts are made by judges, others are embodied in domestic tax legislation, and others in bilateral double tax treaties. Beneficial ownership and limitation on benefits provisions are technical and specific concepts intended to curb abusive forms of treaty shopping.

B. Characteristics of Treaty Shopping

Treaty shopping typically involves three features:

- the beneficial owner of the entity used to treaty shop does not reside in the country (T) where the entity is created;
- the conduit entity has minimal presence or economic activity in the country (T) in which it is located; and
- the income is subject to minimal (if any) tax in the country of the conduit holding company (T).

In the absence of any controls, a foreign person in the above circumstances can reduce its income and avoid source taxation by having the payer pay interest, royalties, compensation, or other deductible amounts through a conduit.

Thus, there are two preliminary questions about treaty shopping:

- Does interposing a conduit in a country to benefit from its treaty network constitute legitimate or abusive tax avoidance?
- If an arrangement or structure is abusive tax avoidance, should it be controlled through domestic antiavoidance provisions in the country of the taxpayer’s residence or through specific bilateral anti-treaty-shopping provisions?

In fact, with the exception of the U.S. treaties, most double tax treaties do not contain specific limitations on the ability of third-country residents to treaty shop. Instead, they rely on the concept of beneficial ownership or on domestic antiabuse legislation to safeguard against hollow conduits. This is in marked contrast with U.S. income tax treaties, which almost invariably contain some—sometimes extensive—limitations on the ability of third-country residents to treaty shop. The last treaty that the United States signed without an LOB article was the Hungary-US. treaty in 1979.

C. Economic Impetus for Treaty Shopping

The impetus for treaty shopping is withholding taxes—sometimes as high as 30 percent—on passive income, such as dividends, interest, and royalties. The withholding tax on dividend payments is particularly punitive because dividends are often subject to economic double taxation, once at the corporate level and again in the hands of the shareholders. To be sure, bilateral treaties usually reduce withholding taxes, but the rate of reduction is uneven and the spread between high-rate and low-rate countries can be significant and substantially affect an MNE’s after-tax return on equity.

In other cases, the treaty shopper’s country of residence may not have a tax treaty with the source country. If it does have a treaty, the treaty may have less favorable terms than another more advantageous treaty.

1. Example

Assume that T resides in a tax haven country (TH) that does not have a tax treaty with the United States. The U.S. requires 30 percent withholding on passive income, but reduces the rate to zero on interest paid to residents of Country Y as a result of the tax treaty between the United States and Y. If T invests $1 million in interest bearing (nonexempt) securities in the U.S. and earns $100,000 interest, it will have to pay a 30 percent withholding tax on its annual interest. T could not offset the withholding tax in its country of residence because it is a tax haven.

T could restructure its loan investment in the United States through a back-to-back loan by using a financial intermediary in Country Y. The financial intermediary would invest in the United States. There would be no withholding tax on interest paid from the U.S. to the financial intermediary in Country Y because of the bilateral tax treaty between the two countries. Assuming that there is no withholding between Country Y and TH (either because of a treaty or by virtue of domestic law), the financial intermediary could then pay the interest payments to T on a gross basis. The financial intermediary in Country Y would not be taxable—except on a small commission fee—because it would deduct the interest payments to T from its interest income from the United States. The net result is that the U.S. would lose its withholding tax at source.

2. Example: Use of Controlled Foreign Corporation

Similarly, T can incorporate a wholly owned company (Company C) or affiliate in Country Y and subscribe for $10 million in shares. Company C could then invest the $10 million in the United States through investments in the public markets. Assuming that the treaty between the U.S. and Country Y reduces the dividend withholding tax rate from 30 percent to 10 percent, there would be a net 20 percent savings on withholding taxes by routing the $10 million investment through Company C. If Country Y does not tax foreign dividends from treaty countries, T can substantially enhance its after-tax rate of return on equity.

The above examples illustrate a feature common to most treaty-shopping arrangements: using a financial intermediary or conduit entity resident in a country with a favorable treaty network. There are essentially two common variations on a theme. A taxpayer may use a direct conduit to shift income from its source to the ultimate recipient and beneficial owner of the income. This requires the creation of a corporation (or other entity) to act as a conduit in a country with a favorable treaty environment and that has a special or preferential exemption under the domestic laws of the country where it is created. Thus, both conditions must be satisfied for the arrangement to be successful:

- the conduit itself must enjoy tax exemption in the country where it is created; and
- the income must pass through the conduit to the beneficial owner with minimum withholding taxes.

A conduit corporation is also useful to convert the character of income as it travels from the source where it is earned back to the beneficial owner of the income. For example, income earned in Country A could pass through as interest on a loan to Country D, which could then transmit the income back to Country C in the form of a dividend. Country A might have a favorable tax treaty with Country B on interest income, and Country D may have a favorable treaty with Country C for dividend distributions. Alternatively, it may be convenient to convert the character of income in those circumstances when the domestic legislation makes it difficult to use back-to-back loans because of thin capitalization rules.

In other circumstances, one can use a conduit corporation to take advantage of a bilateral treaty even if the corporation is subject to full tax in a high-tax jurisdiction, provided it is permitted to deduct its expenses. For example, income from Country A may be channeled to Country C through Country B. If the conduit corporation in Country B is permitted to deduct all its expenses, it can receive interest, dividends, and royalty income from Country A and then pay out a substantial portion of its net income in the form of interest, commissions, service fees, and similar expenses to the ultimate beneficial owner in Country C. Thus, although Country A is a high-tax jurisdiction, the income is transmitted to Country C with minimum tax cost because of the deductions in the conduit corporation.

III. Judicial Control of Treaty Shopping

Experience with treaty shopping varies with flows of capital into and out of the country. Generally, OECD countries have not been in favor of treaty shopping, but, unlike the United States, have not legislated exhaustively on prohibiting it through specific provisions in double tax treaties.

A. The United States

The use of intermediate holding companies in tax-friendly countries is the single most common form of treaty shopping. Aiken Industries Inc.[19] is the classic example. A U.S. company, Aiken Industries Inc., a wholly owned subsidiary of a Bahamian corporation, borrowed $2,250,000 from its parent company in exchange for a 4 percent sinking fund promissory note due in 20 years. A year later, the Bahamian parent corporation assigned the promissory note from Aiken (U.S.) to another wholly owned subsidiary in Ecuador in exchange for nine promissory notes. Each note was payable on demand in the principal amount of $250,000—for a total of $2,250,000—and each bore interest in the amount of 4 percent per year. The Ecuadorian corporation did not have an office, or carry on any business, in the United States.

Under the original arrangement, Aiken Industries would have to withhold United States tax at a non-treaty rate of 30 percent on any interest that it paid to its Bahamian parent corporation. The U.S. did, however, have a favorable treaty with the Republic of Honduras. Article IX provides as follows:

> Interest on bonds, securities, notes or on any other form of indebtedness from sources within one of the Contracting States *received* by a resident, corporation or other entity of the other Contracting State not having a permanent establishment within the former State at any time during the taxable year in which such interest is received, shall be exempt from tax by such former State. [Emphasis added.]

Based on the above structure, Aiken Industries claimed exemption from United States withholding tax on its interest payments.

Article II (g), the definitional article of the Honduras Convention, provides as follows:

> The term “Honduran enterprise” means an industrial or commercial or agricultural enterprise or undertaking carried on by a resident of Honduras … or a fiduciary of Honduras or by a Honduran corporation or other entity; the term “Honduran corporation or other entity” means a corporation or other entity formed or organized in Honduras or under the laws of Honduras.

Article VI, clause 2 of the United States Constitution provides:

> All Treaties made, or which shall be made, under the Authority of the United States shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Clearly, all the parties complied with the formal and technical requirements of the treaty. The Honduras subsidiary of the Bahamian corporation was a duly constituted, legal corporation properly organized under the laws of Honduras. Thus, having complied with the requirements to qualify as a Honduran corporation, it came within the scope of Article IX of the convention.

The court acknowledged:

> Where the formal requirements of a definition established by a treaty are met, the benefits flowing from a treaty as the result of conforming to such formal definitional requirements cannot be denied by an inquiry behind those formal requirements.[20]

The debt, on which interest was payable according to the terms and conditions outlined in the promissory notes, was valid. The transactions represented actual legal rights; they were not shams.

The taxpayer's financing structure clearly minimized its overall tax burden. To be sure, the taxpayer was motivated by tax avoidance. However, that by itself was not a sufficient reason to deny a benefit to the parties to which they were otherwise entitled under the treaty.[21]

In determining whether a treaty protects a taxpayer, the American court looked at the words in the treaty and sought to give them a meaning consistent with the genuine shared—albeit unarticulated—expectations of the contracting parties.[22] The court found that the Honduras corporation did not receive the interest payments within the meaning of Article IX of the treaty. The corporation did not receive the interest in its own right, but only as an agent or conduit obliged to transmit it to its Bahamian parent corporation.

The words "received by" in Article IX referred not merely to the obtaining of physical possession on a temporary basis of funds representing interest payments, but also to complete dominion and control over the funds.[23] The corporation obtained exactly what it gave up in a dollar-for-dollar exchange and was committed to pay out exactly what it collected. It derived no profit from the arrangement but merely acted as a collection agent. Thus, the court in effect restricted the exemption in Article IX of the treaty to circumstances in which interest paid is paid to an entity in its capacity as a "beneficial owner" of the funds. In effect, the court imported the concept of beneficial ownership into the words of the treaty on a theory of the shared expectations of the two governments that had negotiated the treaty.

In *Ingemar Johansson et al v. United State of America,*[24] the taxpayer, a citizen of Switzerland and a world heavyweight boxing champion, earned prize money by boxing in the United States. Johansson formed a company in Switzerland, became its employee, and routed his professional income through the company, which remunerated him as an employee. Johansson sought to take advantage of the Switzerland-US. DTA, which provided that an individual resident in Switzerland shall be exempt from United States tax on compensation for personal services performed in the United States if he is temporarily present in the United States for a period or periods not exceeding a total of 183 during the tax year.

Johansson was not present in the United States for more than 183 days, and the structure was tax driven. Nevertheless, the court observed:

> Of course, the fact that Johansson was motivated in his actions by the desire to minimize his tax burden can in no way be taken to deprive him of an exemption to which an applicable treaty entitles him.

As proof of his residence, Johansson relied on the Swiss Tax Authority's determination that he had become a resident of Switzerland on a particular date. The U.S. court of appeal rejected the taxpayer's claim. The term "resident" was not defined in the Switzerland-U.S. treaty. Thus, Article II authorized each country to apply its own definition to terms not expressly defined "unless the context otherwise required." The US. court held that the determination of the taxpayer's residence status by the Swiss Tax Authority, according to Swiss law, was not conclusive and that the US. tax authorities were entitled to decide it in accordance with the U.S. laws under the treaty. The court held that Johansson was not a resident of Switzerland during the period in question and that the tax exemption in the treaty was not available to him.

In both *Aiken* and *Ingemar Johansson*, the U.S. courts examined the formal structures set up by the taxpayers to determine their substantive content—a substance-over-form approach. The *Aiken* doctrine, however, was not sufficient to curb all treaty-shopping schemes. Because all economic laws are behavioral, it did not take much for tax lawyers to devise more amenable holding company structures to sidestep the doctrine.

In *Northern Indiana Public Service,*[25] for example, the parties set up an Antilles subsidiary conduit corporation that raised $70 million by issuing eurobonds that it then lent to its U.S. parent corporation at an extra percentage point. The interest that the U.S. parent paid to its Antilles subsidiary was exempt from U.S. withholding tax under Article VIII of the Netherlands

Antilles-US. treaty[26] (repealed in 1988). The parties agreed that the entire financing structure was tax motivated and designed to avoid the U.S. withholding tax.

However, tax avoidance motive is not inherently fatal to a tax plan. A taxpayer has a legal right to minimize or avoid taxes.[27] Thus, provided that the taxpayer forms a *viable entity* for *substantive* business activity,[28] it is not a sham, conduit, or mere agent. To be sure, the "substantive" activity may be minimal. It is enough that the activity be substantive; it need not be substantial. Thus, *Northern Indiana* hinged on the $700,000 profit on the interest rate spread of 1 percent, which the Antilles corporation retained.

MNEs can also treaty shop to characterize income for withholding tax purposes. In *SDI Netherlands*,[29] for example, SDI Netherlands acquired nonexclusive worldwide rights to software from SDI Bermuda for use on IBM mainframe computers. SDI Netherlands agreed to pay 93 percent of the net amount (after deduction of withholding tax) of all royalties that it received from sublicensees to SDI Bermuda. SDI Netherlands in turn granted exclusive sublicenses of the software to SDI U.S., its wholly owned subsidiary. SDI U.S. paid gross royalties to SDI Netherlands without withholding tax under article 13 of the Netherlands-US. treaty, which in part reads as follows:

> 1. Royalties arising in one of the States and beneficially owned by a resident of the other State shall be taxable *only* in that other State.
>
> 2. The term "royalties" as used in this Convention means payments of any kind received as a consideration for the *use of, or the right to use*, any copyright of literary, artistic, or scientific work (but not including motion pictures or works on film, tape or other means of reproduction used for radio or television broadcasting), any patent, trademark, trade name, brand name, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. The term "royalties" also includes gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof.
>
> 3. The provisions of paragraph 1 shall *not* apply *if the beneficial owner* of the royalties, being a resident of one of the States, carries on business in the other State, in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be, shall apply. [Emphasis added.]

The article is based on the OECD model, which grants the residence country exclusive taxing jurisdiction over royalties.

The central issue was whether SDI Bermuda derived royalties from U.S. sources:

- Did the U.S. royalties retain their character as U.S.-source income and flow through to SDI Bermuda?
- Was SDI Netherlands merely a conduit company as in *Aiken Industries*?
- Did the U.S. royalties merge with other royalties and lose their identity as U.S.-source income?

The Internal Revenue Service maintained that the royalties retained their character as U.S.-source royalties as they flowed through the Netherlands corporation, and, as such, were liable to U.S. withholding taxes. The court held that royalties to the Bermuda company did not derive from the U.S.; therefore, there was no withholding required.

SDI Netherlands was a valid foreign corporation. The arrangements between the affiliated corporations were valid. SDI Netherlands was not a conduit or agent of the Bermuda company. The Bermuda company was not the beneficial owner of the royalties so as to negate the treaty.

The table compares Aiken, Northern Indiana, and SDI Netherlands.

Comparison of Aiken, Northern Indiana, and SDI Netherlands

Relevant Factors	Aiken Industries	Northern Indiana	SDI Netherlands
Nature of entity	Foreign corporation	Foreign corporation	Foreign corporation
Relationship	Close relationship between three companies	Not close; borrowings by finance subsidiary were from unrelated parties	Close relationship between all companies
Terms	Identical terms of loans	Small difference in terms and interest rates	Separate and distinct terms and conditions:
			• exclusivity
			• spread
Timing	Back-to-back loans and payments		
Cascading			Potential for, but not here

B. India

Some countries tolerate treaty shopping and the use of conduit corporations to minimize tax as a legitimate extension of international tax planning. For example, the 1982 India-Mauritius income tax treaty in effect exempts capital gains that residents of Mauritius derive from disposing of shares in India. Hence, Mauritius is a good choice to incorporate a conduit—intermediate holding company—to structure an MNE's route into India.

On several occasions before 2003, the Indian Advance Rulings Authority held that it would provide relief under a treaty only to avoid double taxation. There would be no relief if the result would be double nontaxation.[30] In 2003 Indian courts weighed in on whether treaty shopping is permitted under principles of international law in OECD model treaties that do not contain specific LOB provisions.

In *Union of India v. Azadi Bacho Andolan*,[31] the issue involved companies incorporated in Mauritius to facilitate investments in India. The corporations did nothing other than hold shares of Indian companies. Under the India-Mauritius double taxation avoidance convention, persons (including corporations) resident in Mauritius were exempt in India on capital gains arising on the disposition of their Indian corporation shares if the value of the shares of the Indian corporations did not derive principally from real estate in India. As Mauritius did not impose capital gains taxes on the disposition, the disposition would occur free of tax in both jurisdictions (double nontaxation).
The Indian Supreme Court confirmed that treaty shopping has been permitted under international law for over 40 years. The Court outlined the differences in views between developed and developing countries on attitudes toward treaty shopping; hence, it would require specific provisions in India's treaties to overcome the established jurisprudence. Interestingly, the Court relied on two Canadian cases in arriving at its decision:[32]

> Many developed countries tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to a significant loss of tax revenues. Moreover, several of them allow the use of their treaty network to attract foreign enterprises and offshore activities. Some of them favour treaty shopping for outbound investment to reduce the foreign taxes of their tax residents but dislike their own loss of tax revenues on inbound investment or trade of non-residents. In developing countries, treaty shopping is often regarded as a tax incentive to attract scarce foreign capital or technology. They are able to grant tax concessions exclusively to foreign investors over and above the domestic tax law provisions. In this respect, it does not differ much from other similar tax incentives given by them, such as tax holidays, grants, etc. (Roy Rohtagi, *Basic International Taxation*, Kluwer Law

> International, pp. 373-374). Developing countries need foreign investments, and the treaty shopping opportunities can be an additional factor to attract them. The use of Cyprus as a treaty haven has helped capital inflows into Eastern Europe. Madeira (Portugal) is attractive for investments into the European Union. Singapore is developing itself as a base for investments in South East Asia and China. Mauritius today provides a suitable treaty conduit for South Asia and South Africa. In recent years, India has been the beneficiary of significant foreign funds through the "Mauritius conduit". Although the Indian economic reforms since 1991 permitted such capital transfers, the amount would have been much lower without the India-Mauritius tax treaty (*Basic International Taxation*).
>
> Overall, countries need to take, and do take, a holistic view. The developing countries allow treaty shopping to encourage capital and technology inflows, which developed countries are keen to provide to them. The loss of tax revenues could be insignificant compared to the other nontax benefits to their economy. Many of them do not appear to be too concerned unless the revenue losses are significant compared [footnotes omitted] to the other tax and non-tax benefits from the treaty, or the treaty shopping leads to other tax abuses (*Basic International Taxation*).

After the *Azadi Bachao* decision, and seemingly at odds with it, the Indian Advance Rulings Authority held that individuals resident in the United Arab Emirates who were not subject to tax in the U.A.E. would not be entitled to the benefits of the India-U.A.E. double tax convention. As a result, the individuals were taxable in India.[33]

C. Canada

Canada has considered treaty shopping and beneficial ownership in two cases, one involving residence for treaty purposes and the other beneficial ownership of property. The courts decided both in favor of the taxpayer. In MIL (Investments) SA v. The Queen, 2006 CanLII 29001 (T.C.C.) , the issue was whether capital gains of approximately C $425 million were exempt from Canadian income tax by virtue of the Convention Between Canada and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and on Capital.

The taxpayer, a Caymanian company, was reincorporated into Luxembourg before the sale of shares that subsequently triggered a substantial capital gain. Under article 13(5) of the treaty, the gains were taxable in the state of residence (Luxembourg) and not in Canada. The Canada Revenue Agency argued that the entire (complex) arrangement constituted abusive treaty shopping and therefore should be treated as an abuse of law. Justice B. Richard Bell rejected any overarching theory outlawing treaty shopping:

> There is nothing inherently proper or improper with selecting one foreign regime over another. Respondent's counsel was correct in arguing that the selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the use of the selected treaty that must be examined.
>
> Canada has negotiated a broad network of carefully negotiated tax conventions with many different nations. Prior to negotiating the Treaty, Canada undoubtedly had knowledge of Luxembourg's treatment of capital gains.

The second decision involved beneficial ownership of shares. The concept of beneficial ownership is an antiabuse mechanism that targets a prevalent form of treaty shopping—the use of intermediate holding companies to reduce withholding tax rates. The concept is related to anti-treaty-shopping in that it attempts to confine treaty benefits to legitimate residents of the treaty country.

The term "beneficial ownership" appears in three principal articles of income tax treaties: dividends, interest, and royalties—typically, articles 10, 11, and 12. Most OECD-modeled treaties provide a reduced withholding tax rate for taxpayers that have a substantial ownership interest in an affiliated holding company, provided that the shareholder *beneficially owns* the property interest. A holding company is a "corporation organized for the purpose of owning and holding the stock of other corporations."[34]

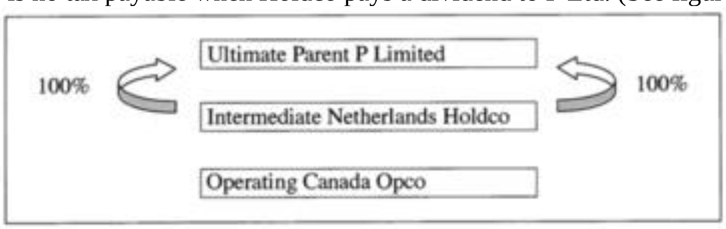
For example, article 10(2) of the Canada-Netherlands tax convention is a typical OECD-modeled dividend clause:

> (1) Dividends paid by a company which is a resident of one of the States to a resident of the other State may be taxed in that other State.
>
> (2) However, such dividends may also be taxed in the State of which the company paying the dividends is a resident, and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed:
>
> > 5 percent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) that owns at least 25 percent of the capital of, or that controls directly or indirectly at least 10 percent of the working power in, the company being the dividends ….

Here we see the source country provide a preferential rate of 5 percent, but only if the recipient beneficially owns at least 25 percent of the capital of the affiliated company that pays the dividend or controls 10 percent of its working shares.

The beneficial ownership concept does not require motive or purpose to apply. Thus, the test devolves into one of facts and circumstances in each case. In what circumstances can the tax authorities look through the legal form of holding companies to determine the economic substance of their shareholdings to determine who beneficially owns the property interest?

Assume, for example, that P Ltd.—a company resident in Sweden—incorporates a subsidiary (Holdco) in the Netherlands that purchases the shares of an operating company (Opco) in Canada. Assume that the withholding tax on any dividend directly payable to P Ltd. would have been 15 percent. Assume also that the tax on a dividend payable by Opco to Holdco is only 5 percent. Further, there is no tax payable when Holdco pays a dividend to P Ltd. (See figure.)



Figure

Corporations may have many different incentives to structure their business in this particular way. Even if tax is not the overriding factor in a particular structure, tax considerations will always affect an MNE’s return on equity. If P Ltd. wanted to establish its presence in a foreign country, it would select a route that has favorable tax consequences. The Netherlands is often a tax-efficient route for many MNEs. For example, the above structure can be tax efficient for inbound transactions into Canada because it reduces the withholding tax on dividends to 5 percent under the Canada-Netherlands treaty. However, the 5 percent rate applies only if the Netherlands intermediate Holdco *beneficially owns* the shares in the Canadian Opco.

How do we reconcile the concepts of beneficial ownership with the separate legal entity status of corporations? In economic terms, Holdco is a conduit between Opco and P Ltd. However, Holdco is also a separate legal entity that is properly constituted in the Netherlands. Thus, the legal form of the transaction is unimpeachable. Holdco is the legal shareholder of Opco and is therefore *legally entitled* to receive any dividends that Opco pays. Indeed, as a matter of corporate law, Opco cannot pay a dividend directly to P Ltd. But who *beneficially owns* Opco? That was the issue the Canadian Federal Court of Appeal faced in *Prévost*.[35]

The OECD added the beneficial ownership clause to its model convention in 1997 to prevent tax abuse through treaty shopping. The Conduit Companies Report explained the meaning of beneficial owner as follows:

> The Commentaries mentioned a case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contract or takes over obligations under which he has a similar function to those of a nominee or an agent. Thus a conduit company can normally not be regarded as a beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company).

IV. The Meaning of Beneficial Ownership

Beneficial ownership is a common-law trust concept that has no equivalent in civil-law countries.[36] The concept distinguishes beneficial rights from legal title. A beneficial owner may have the power to vote or dispose of shares depending upon the terms of the trust.

The concept of beneficial ownership has different facets depending on the context in which it appears. In tax law, the concept can provide relief or be used to challenge transactions. The Canadian Income Tax Act, for example, recognizes that a transfer of property to a trust is not a disposition for tax purposes—and therefore does not trigger capital gains—when there is no change in the beneficial ownership of the property.[37] In contrast, for corporate purposes under Australian law, transactions that do not involve a change in beneficial ownership may be considered to create a false appearance of active trading, unless the transaction had a contrary purpose.[38]

However, the meaning of beneficial owner remains unclear because various legal systems interpret the concept differently The words have different meanings in English common law, civil law, Dutch law, and international law The OECD model convention does not define the term “beneficial ownership” or “beneficial owner” but merely attempts to describe the character of beneficial ownership.

In common-law countries, the concept of beneficial rights derives from trust law. Trust law allows for the division of property interests into legal and beneficial interests. The law allocates equitable rights to the beneficiary and legal rights to the trustee, who holds the title to the trust property. Strictly speaking, the beneficiary does not own trust property. He merely has the right to enforce the terms of the trust, which may provide that the beneficiary acquire ultimate ownership of the trust property.

The OECD comprises nearly 30 countries, few of which have common-law systems. In Canada there is an added complication: 12 Canadian provinces and territories have common-law systems; Quebec does not. Given the diversity of legal systems, OECD countries would not likely use the phrase “beneficial owner” in the strict sense of English trust law. The OECD amended its commentary in 2003 in paragraph 12 to say so: “The term ‘beneficial ownership’ is not used in a narrow technical sense” in the context of English law.

Because the OECD model and treaties based on it do not define beneficial ownership, we must look to the domestic law of the relevant treaty partners.[39] Article 3(2) of the Canada-Netherlands treaty states:

> As regards the application of the Convention by a State any term not defined there shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the convention applies.

The article is not helpful. Canada does not define beneficial ownership under its domestic law.

The Income Tax Conventions Interpretations Act (ITCIA) (1984) of Canada provides some interpretive guidance in determining the meaning of undefined treaty terms. Section 3 states that undefined terms, *except to the extent that the context otherwise requires*, should have an ambulatory meaning and evolve with changes made to Canadian tax law.[40] Thus, as a first step, we must examine the context in which the concept of beneficial ownership arises. This takes us back to the OECD commentary.

The OECD's Conduit Companies Report speaks of a "mere fiduciary" not being a beneficial owner. This statement is minimally helpful. The notion that a person can be a "mere" fiduciary is paradoxical. "Fiduciary" refers to the obligations that the common law imposes on some classes of people—such as trustees and corporate directors—who have serious responsibilities for the administration of assets under their supervision and control. The report uses the concept of "a mere fiduciary or an administrator" in the sense of the person being a bare "agent or nominee" who is under the direction of some other person.

The word "agent," which derives from the law of agency, also has many different meanings in law. Strictly speaking, an agent is a person who has the legal power to affect the legal relationships of his principal in dealings with third parties. An agent is often a fiduciary, and the law holds agents to a high standard of prudence and responsibility.

In *Prévost*, P Ltd., represented by two companies, was the legal owner of Holdco's shares. Holdco was a separate legal entity with its own corporate responsibilities. Under Canadian law, the directors of Holdco would owe a fiduciary duty to Holdco and not to its shareholder (P Ltd.). This is so even if the directors of P Ltd. appoint and elect the directors of Holdco. Thus, Holdco would not be a "mere fiduciary." The third meaning of beneficial ownership—the one the OECD commentary prefers—is that one must look to see whether the conduit company (Holdco) is merely a "nominee or administrator" that acts on instructions with very narrow powers. Paragraphs 12 to 12.2 of the commentary state:

> Where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee … it would be inconsistent with the object and purpose of the Convention for the State or source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State. The immediate recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. It would be equally inconsistent with the object and purpose of the Convention for the State forced to grant relief or exemption where a resident of a contracting State otherwise than through an agency or a nominee relationship, simply act as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons the [Conduit Company Report] concludes that the conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical manner, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested bodies.

This test looks at the relationship and role of the conduit company in a practical manner. The test examines the de facto governance model and composition of the conduit company's parent board and its actual duties of corporate management. The greater the legal responsibilities of the conduit's board of management, the greater the likelihood that the conduit is both the legal and beneficial owner of its subsidiary's shares. One must look further than the stated legal responsibilities to determine whether the conduit's management is real in a practical sense.

Thus, there is no bright-line test of beneficial ownership to guide taxpayers. One must examine each factual pattern to determine the real—and not merely legal—relationship of the conduit in the context of its actual obligations and duties between the subsidiary and the ultimate parent company. The determination is essentially one of fact.

A. Jurisprudence

Even before the Canadian decision in Prévost, the jurisprudence on the meaning of beneficial ownership in tax treaties was sparse. The Hoge Raad decision of November 7, 1980, under article 10(2) of the Netherlands-U.K. treaty is interesting.[41] In 1995 a corporate stockbroker residing in the United Kingdom purchased dividend coupons of Royal Dutch Shell from a Luxembourg company. The stockbroker purchased his coupon rights after Royal Dutch Shell had declared—but not paid—its dividend. The stockbroker did not purchase the underlying shares of Royal Dutch Shell. The Hoge Raad held that the stockbroker was the beneficial owner of the dividend and was therefore entitled to the reduced withholding tax rate applicable under the treaty. The Court stated:

> The interested party has, by purchasing the dividend coupons, become their owner. This Court may further assume that the interested party had, after their purchase, the free disposal of the dividend coupons and, after cashing them, of the distributions received and that, when cashing the dividend coupons, it did not act as agent or nominee. Under those circumstances, the interested party may be considered to be the beneficial owner of the dividends.

Despite that the stockbroker did not own the underlying property, but merely the income right from it, the Court considered him to be the beneficial owner of the dividend. The stockbroker may have been entitled to the income attached to the coupons. He did not, however, have any ownership, either legal or beneficial, in the underlying shares on which the company paid the dividend. The Court assumed that the stockbroker could freely dispose of the dividend coupons and therefore “did not act as agent or nominee.” That, however, was the question: Was the stockbroker acting as an agent or nominee? The Court assumed its conclusion.

In *Prévost*, Judge (now Chief Justice) Gerald J. Rip held that the beneficial owner of dividends routed through an intermediate holding company in the Netherlands was the person who received the dividends for his own use and enjoyment *if* he assumed the risk and control of the dividend. The Federal Court of Appeal agreed. The CRA argued that the concept of beneficial owner of a dividend is “the person who can, in fact, ultimately benefit from the dividend”—a highly pejorative analysis for intermediate holding companies and one that was unsupported by domestic or international treaty law.

A foreign recipient of dividends, interest, or royalties is the beneficial owner of the income if he has the discretion to deal with the payments. This is the foundation for using foreign holding companies resident in treaty countries and international tax structures routed through low-tax treaty jurisdictions.

In arranging a holding company’s structures, tax planners should consider the following factors:

- Do the holding company’s financial statements show that it owns the assets and has the liabilities on its books?
- How does Holdco account for its flow of income?
- Do the directors of Holdco have discretionary powers, or are they mere puppets?

The flow of income through the holding company should not be predetermined or automatic but should rest on the exercise of corporate discretion in Holdco. The directors of the holding company should act as directors and approve all payments in a proper corporate manner. In effect, Holdco and its directors should behave as a corporate entity, with the directors exercising independent discretion.

The absence of traditional corporate indicia—a fiscal office or employees in the holding company jurisdiction and the use of a third party to pay the income through the holding company—is not an absolute factor.

B. Treaty Interpretation

Prévost raised a disturbing aspect of judicial interpretation of treaties—the reliance of courts on interpretational commentaries drafted after the particular treaty under review. To be sure, the 2003 model convention states that OECD members should interpret bilateral treaties in accordance with the commentary “as modified from time to time” and “in the spirit of the revised Commentaries.” That, however, is merely the OECD’s expectation. The OECD is a body of government representatives. It is not a lawmaking body in its own right.

Nevertheless, in *Prévost*, the Federal Court of Appeal concluded that the OECD conduit companies’ report (released in 1986) and the OECD’s 2003 amendments were a “helpful complement” in interpreting a treaty that was signed many years earlier. The use of the commentaries to retroactively interpret treaties that predate it makes fiction of the contractual intention of the parties at the time they signed the treaty.

In reaching its conclusion, the Federal Court of Appeal distinguished its own previous decision in *CUDD Pressure* in a novel manner:

> I pause here to observe that counsel for both sides agreed that the Judge was entitled to rely on subsequent documents issued by the OECD in order to interpret the Model Convention. I share their view. It is true that this Court, in *CUDD Pressure Control Inc. v. The Queen,* 98 DTC 6630, at 6635, qualified the relevance of the 1977 Commentary as being "somewhat suspect" in the search of the intention of the drafters of a Convention signed 35 years earlier, in 1942, but there was no model convention in 1942 and, in any event, Robertson J.A., for the Court, went on to recognize the OECD Commentaries "can provide some assistance" as the 1942 Convention follows the same general principles as the 1972 OECD Model. To the extent that it might be said that a contrary was view expressed by the Tax Court… it does not appear such a view was in the mind of this Court when it dismissed the appeal from the Bench, 2009 FCCA 236.

Thus, although commentaries subsequent to the signing of the treaty may be "somewhat suspect," they can provide "some assistance" in determining beneficial ownership in a "practical manner." A conduit company that is contractually required to pay dividends, interest, or royalties to a third party requires careful scrutiny to determine whether the conduit is an agent or nominee. The directors of a corporation should have discretion to pay dividends on the corporation's shares. When the directors commit themselves to pay through the dividends that the conduit receives, it cannot be said that they are exercising discretion. Quite apart from corporate law ramifications of such an action, the so-called directors are not acting *qua* directors but are mere conduit nominees of the third party.

V. Conclusion

There is no clear international consensus on controlling treaty shopping and restricting treaty benefits. Despite some early success in the United States, it became clear that countries can only control treaty shopping through specific and detailed LOB provisions. That is the route that the U.S. took and continues to press in its treaties.

Developing countries such as India have a more benign view of controlling treaty shopping through judicial interpretation and prefer to leave such matters to the executive branch of government to negotiate.

Given the Canada Revenue Agency's significant losses in attempting to control treaty shopping using the concept of beneficial ownership, we can expect to see future Canadian treaties containing specific LOB articles (such as in the fifth protocol to the Canada-US. treaty) as a more effective way of controlling tax avoidance. In the interim, however, *Prévost* should give MNEs some comfort in locating subsidiaries in tax-friendly countries as a means of improving their after-tax return on equity.

Vern Krishna, CM, QC, FRSC is Tax Counsel, Borden Ladner Gervais, LLP, and Professor of Common Law and Executive Director of the Tax Research Centre, University of Ottawa.

vern.krishna@taxchambers.ca

Footnotes

1 Also referred to as double tax agreements (DTAs).

2 *See, e.g.,* subsection 239(1), Income Tax Act (Canada).

3 Hence, the conundrum: UBS AG admitted to being party to fraudulent activities that resulted in the deferral of criminal prosecutions but asserted that fraud is not the same as tax evasion and so will not disclose the requested information. All of which puzzled the United States Senate. According to Sen. Carl Levin, D-Mich., cochair of the subcommittee investigating tax evasion by U.S. clients of UBS:

> The question then is of what value is our treaty with them if even when they have accepted responsibility for violating our law—their words—and where they have participated in a scheme to

> defraud our IRS, if we can't get the names of the people with whom they schemed.

4 69 F.2d 809 (2nd Cir. 1934) , 810.

5 *IRC v. Duke of Westminster,* [1936] A.C.. *See also* Lord Sumner in *IRC v. Fisher's Executors,* [1926] A.C 395, 412:

> My Lords, the highest authorities have always recognised that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed terms or any omissions that he can find in his favour in taxing Acts. In so doing, he neither comes under liability nor incurs blame.

6 *See, e.g., Craven v. White,* [1983] 3 All ER 495:

> It remains true in general that the taxpayer, where he is in a position to carry through a transaction in two alternative ways, one of which will result in liability to tax and the other of which will not, is at liberty to choose the latter and to do so effectively in the absence of any specific tax avoidance provision. [Per Lord Keith at p. 500.]

SeeBradford (Borough of) v. Pickles, [1895] A.C. 587, where Lord Halsbury said:

> If it was a lawful act, however ill the motive might be, he had a right to do it. If it was an unlawful act, however good his motive might be, he would have no right to do it. [At p. 594.]
>
> No use of property, which would be legal if due to a proper motive, can become illegal because it is prompted by a motive which is improper or even malicious. [*Per* Lord Watson, at p. 598.]

7 B. Larking (ed.), *International Tax Glossary*, Amsterdam: International Bureau of Fiscal Documentation, 2001, 4th Ed.

8 *See* Commentary to Article III of the OECD model.

9 *See, e.g., Maximov v. United States,* 299 F.2d 565 (2d Cir. 1962) , *affd* 373 US. 49(1963).

10 U.K. courts have held that "person" includes a partnership for the purposes of the Jersey-U.K. treaty. *Padmore v. IRC,* [1987] STC 36 and [1989] STC 493.

11 Subsection 250(4), ITA (Canada).

12 At paras. 7 and 7.1.

13 OECD Commentary para. 8.

14 OECD Commentary, para. 9.1-9.3.

15 *See, e.g.*, proposed amendments to the Canadian General Anti-Avoidance Rule, section 245 of the ITA, which were released March 23, 2004, and under which an abuse of a treaty would be considered to be an antiavoidance transaction under Canadian domestic law.

16 OECD Commentary, paras. 20-22.2.

17 *See, e.g.*, Article XXIXA, Canada-U.S. treaty at para. 7.

18 *Aiken Industries, Inc. v. Commissioner,* 56 T.C. 925 (1971) .

19 56 T.C 925.

20 *Maximov v. United States,* 373 U.S. 49 (1963) ; *Bacardi Corp. v. Domenech,* 311 US. 150 (1940) .

21 *Gregory v. Helvering,* 293 US. 465 (1935) , 469.

22 *Maximov v. United States,* 299 F. 2d 565, 568, *aff'd* 373 U.S. 49 (1963).

23 *Id*. at 933.

24 336 F.2d 809.

25 115 F.3d 506 (7thCir.).

26 Netherlands-US. treaty, Article VIII(l):

> Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness), other than interest referred to in Article V of the present Convention, derived from sources within the United States by a resident or corporation of the Netherlands not engaged in trade or business in the United States through a permanent establishment, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a Netherlands corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

27 *Gregory v. Helvering,* 293 U.S. 465 (1935) , 469. *See alsoYosha,* 861 F.2d ("There is no rule against taking advantage of opportunities created by Congress or the Treasury Department for beating taxes"); *Aiken Industries,* 56 T.C. at 933 ("The fact that the actions taken by the parties in this case were taken to minimize their tax burden may not by itself be utilized to deny a benefit to which the parties are otherwise entitled under the convention"); *Bass v. Commissioner,* 50 T.C. 595 (1968) , 600 ("A taxpayer may adopt any form he desires for the conduct of his business, and … the chosen form cannot be ignored merely because it results in a tax saving").

28 *Bass v. Commissioner,* 50 T.C. 595 (1968) , 600 (the form chosen for business "must be a viable business entity, that is, it must have been formed for a substantial business purpose or actually engage in substantive business activity"); *Yosha,* 861 F.2d ("There is a doctrine that a transaction utterly devoid of economic substance will not be allowed to confer [a tax] advantage"); *Gregory v. Helvering,* 293 U.S. 465 (1935) , at 469 ("What was done, apart from the tax motive, was

the thing that the [treaty] intended").

29 107 T.C. 161 (1996) .

30 *SeeCyril Pereira,* 239 ITR 650; pp. 34-35, 241 ITR 61.

31 [2003] 4 LRI 172 (Supreme Court of India (Civil Appellate Division)) 263 IRT 706.

32 *Gladden v. The Queen,* 85 DTC 5188 (FCTD) , and *Hausmann Estate v. The Queen,* [1988] 4 CTC 2232 (TCC) .

33 *Abdul Razak*. *See* Rakesh Kapur and Radhakishan Rawal, "India," *The Attribution of Profits to Permanent Establishments*, International Fiscal Association: Cahiers de Droit Fiscal International, Vol. 91b, 2006 Amsterdam Congress, p. 403.

34 *See* http://www.crfonline.org/orc/glossary/h.html. *See generally* Klaus Vogel, "The OECD Model Convention—1998 and Beyond," *The Concept of Beneficial Ownership in Tax Treaties*, 1998, p. 23.

35 See *Prévost Car Inc. v. The Queen,* [2004] 4226 (TCC) ; [2008] FCA.

36 Mark D. Brender, "*Beneficial Ownership in Canadian Income Tax Law*," Bijurilex, *available at* http://www.bijurilex.org/ site/att/BRENDER-Propriete_effective_2002-08-20_E.htm (last checked Mar. 23, 2009).

37 *See* para. 248(1), "Disposition."

38 The Corporations Act 2001, sections 1041B(2) and 1041B(3).

39 Article 3(2) of the OECD model states that in the absence of a specific treaty definition, one should apply the domestic law of the relevant jurisdiction.

40 *See* Technical Note (Apr. 5, 1984), Department of Finance, ITCIA: "the purpose of section 3 is to ensure that for the purposes of determining Canadian tax, the meaning of undefined words and expressions contained in Canada's conventions will evolve with the changes made to Canadian tax law." *See alsoHinkley v. R,* 91 BTC 1336 (TCC) at para. 23 ("This section has for purpose *inter alia* to ensure that the terms of the Convention are to be interpreted in accordance with the other case law").

41 Hoge Raad, Apr. 6, 1994, No. 28683, reported in BNB 1994-217, discussed in (1994) ET 469-472, and also discussed in H. Pijl, "The Definition of 'Beneficial Owner' Under Dutch Law" (2000), *Bull. I.B.ED.* 256-260.

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