Canada Intent on Stoppin' the Shoppin' and More

by Michael N. Kandev

Michael N. Kandev is a partner with Davies Ward Phillips & Vineberg LLP in Montreal.

The views in this article are those of the author and do not necessarily reflect those of Davies Ward Phillips & Vineberg LLP.

Canada's federal budget for 2013 announced a consultation on treaty shopping.[1] A background paper was released on August 12, 2013, to serve as the basis for a discussion between the government and stakeholders regarding treaty shopping.[2] The paper suggested that the government favors a general domestic anti-treaty-shopping rule that would serve as a treaty override. The consultation closed on December 13, 2013, with few comments having been submitted. What seems to have come through very clearly from the submissions, and most notably those of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada (representing Canadian tax lawyers and accountants) and the Tax Executives Institute (representing tax executives) is that the government has not made a clear case for the need of an anti-treaty-shopping rule and that there are serious concerns with the government's perceived direction on this issue.[3]

Despite the outcome of the consultation process, in this year's budget, released on February 11, 2014, the government announced a next step in its consultation on treaty shopping, requesting comments on a blueprint for a radical domestic anti-treaty-shopping treaty override and the application of the provision to five hypothetical examples.[4] This article provides some general comments on the wording and structure of the

---

[1] *See* http://www.budget.gc.ca/2013/doc/plan/toc-tdm-eng.html. The government uses the term ''treaty shopping'' to refer to arrangements under which a person not entitled to the benefits of a particular tax treaty with Canada uses an entity that is a resident of a state with which Canada has concluded a tax treaty to obtain Canadian tax benefits.

[2] *Available at* http://www.fin.gc.ca/activty/consult/ts-cf-eng.asp.

[3] The consultation submissions are *available at* http://www.fin.gc.ca/consultresp/ts-cf-eng.asp.

[4] Notably, on March 14, 2014, the OECD published a discussion draft on action 6 of the base erosion and profit-shifting action plan that deals with ''preventing the granting of treaty benefits in inappropriate circumstances.'' The draft recommends a broad treaty-based approach as follows:

- to include a series of instruments in tax treaties to counter tax treaty abuse, in particular treaty shopping, which consist of:
  - — a limitation on benefits provision, such as included by the U.S. in its tax treaties;
  - — a general antiabuse rule in the form of a ''one of the main purposes test'' (similar to the one proposed by the Canadian government); and
  - — other antiabuse provisions for certain specific situations, such as for dual-resident entities and for low-taxed permanent establishments in a third state (triangular cases);
- to ensure that treaties do not prevent the application of specific antiabuse provisions in domestic laws;

(Footnote continued on next page.)

proposed rule and analyzes the examples provided by the government.[5]

General Comments

The main elements of the proposed rule to address treaty shopping, as described in the 2014 budget, are as follows:

- *Main Purpose Provision*: Subject to the relieving provision, a benefit would not be provided under a tax treaty to a person for an amount of income, profit, or gain (relevant treaty income) if it was reasonable to conclude that one of the main purposes for undertaking a transaction, or a transaction that is part of a series of transactions or events, that results in the benefit was for the person to obtain the benefit.
- *Conduit Presumption*: It would be presumed that one of the main purposes for undertaking a transaction that results in a benefit under a tax treaty (or that is part of a series of transactions or events that results in the benefit) was for a person to obtain the benefit if the relevant treaty income is primarily used to pay, distribute, or otherwise transfer, directly or indirectly, at any time or in any form, an amount to another person or persons who would not have been entitled to an equivalent or more favorable benefit had the other person or persons received the relevant treaty income directly.
- *Safe Harbor Presumption*: Subject to the conduit presumption, it would be presumed that none of the main purposes for undertaking a transaction was for a person to obtain a benefit under a tax treaty for relevant treaty income if:
  - — the person (or a related person) carried on an active business (other than managing investments) in the state with which Canada has concluded the tax treaty and, when the relevant treaty income was derived from a related person in Canada, the active business was substantial compared with the activity carried on in Canada giving rise to the relevant treaty income;
  - — the person was not controlled, directly or indirectly in any manner, by another person or persons who would not have been entitled to an equivalent or more favorable benefit had the other person or persons received the relevant treaty income directly; or
  - — the person was a corporation or a trust the shares or units of which were regularly traded on a recognized stock exchange.
- *Relieving Provision*: If the main purpose provision applied in respect of a benefit under a tax treaty, the benefit would be provided, in whole or in part, to the extent that it was reasonable under all the circumstances.

Following are general observations on the wording and structure of the government's proposal:

- Although the government has repeatedly emphasized that it wants to prevent abusive treaty shopping, the proposed provision does not require a determination of whether an impugned structure frustrates the government's treaty policy. This is deplorable though unsurprising; the government seems intent on enacting a provision that would make it easier for it to challenge treaty shopping cases than it would be under the general anti-avoidance rule in section 245.[6]
- The proposed anti-treaty-shopping rule is based on a subjective-objective purpose test. Treaty benefits would be denied if ''it is reasonable to conclude that one of the main purposes'' for the transactions at issue was to obtain the treaty benefit. The fundamental problem with this formulation is that the key expression ''one of the main purposes'' is confusing. Although this terminology has gained the government's favor and can be found both in Canada's tax treaties[7] and in the Income Tax Act,[8] it is problematic. While the adjective ''main'' suggests a single something that is ''chief, principal,''[9] the reference to ''one of'' implies there can be more than one of that thing.

- to include in the OECD model tax treaty a clear statement that tax treaties are intended to eliminate double taxation without creating opportunities for tax evasion and tax avoidance; and
- to amend the introduction to the OECD model tax treaty to provide for a clearer articulation of the tax policy considerations that are relevant to the decision of whether to enter into a tax treaty or amend an existing tax treaty.

[5]This article does not attempt to address all the significant issues regarding treaty shopping. Many of these have been dealt with in the consultation submissions. *See also* Steve Suarez, ''Canada to Unilaterally Override Tax Treaties With Proposed New Anti-Treaty-Shopping Rule,'' *Tax Notes Int'l*, Mar. 3, 2014, p. 797. For prior discussions of this topic by this author, see M. Kandev, ''Treaty Shopping in Canada: The Door Is (Still) Open,'' *Bulletin for International Taxation* (2008) 62(10), 463; Kandev, ''Treaty Shopping After Prévost Car: What Does the Future Hold?'' *International Tax Seminar, 2009* (Kingston, Ontario: International Fiscal Association (Canadian Branch), 2009), at 3:1-25; Kandev, ''Treaty-Shopping Consultation,'' *Canadian Tax Highlights,* Vol. 21, No. 5 (2013), 4.

[6]In essence, the GAAR requires for its application a tax benefit resulting from an avoidance transaction that is abusive.

[7]*See*, *e.g.*, the Canada-Hong Kong tax treaty, article 10(7).

[8]R.S.C. 1985 (5th Supp.) c. 1. *See*, *e.g.*, section 94.1.

[9]*See Webster's Ninth New Collegiate Dictionary*.

Hence, the expression ''one of the main purposes'' should be dropped in favor of a more accurate qualifier such as the word ''primarily,'' as that is used in the avoidance transaction test at subsection 245(3).

- Because of the very broad overriding conduit presumption, the proposed purpose test would effectively be sidestepped in favor of a mechanical rule in many cases. Practically, if the relevant treaty income is primarily used to pay, distribute, or otherwise transfer, directly or indirectly, at any time or in any form, an amount to another person or persons who would not have been entitled to an equivalent or more favorable benefit had the other person or persons received the relevant treaty income directly, treaty benefits would be denied without the ability to save them by reference to bona fide purpose and with little hope of redemption.
- Because of the overriding status of the conduit presumption, the proposed safe harbor rules would be of limited, if any, practical help.
- The rule is in no way limited in its application to related-party transactions.
- The application of the relieving provision is discretionary on the part of the government and hence highly uncertain.
- The proposal does not contain a derivative benefit rule but for the control rule in the safe harbor presumption.

The remaining comments to the proposed anti-treaty-shopping rule are contained in the analysis below of the examples provided in the 2014 budget.

Comments on the Government's Examples

Example 1

In the first example, a treaty-resident corporation, Bco, is interposed between a non-treaty-resident company, Aco, and its Canadian subsidiary, Canco. Aco assigns its right to receive royalty payments from Canco to Bco; in exchange, Bco agrees to remit 80 percent of the royalties received to Aco within 30 days of receipt.

The government comments on this example that because the royalties received by Bco from Canco are primarily used to pay an amount to Aco and Aco would not have been entitled to a tax treaty benefit had it received the royalties directly from Canco, under the conduit presumption, it would be presumed that one of the main purposes for the assignment of the royalties is for Bco to obtain the benefit of the withholding tax reduction under the tax treaty between Canada and State B. Consequently, regarding the royalty payments, the main purpose provision would apply to deny the benefits under the tax treaty between State B and Canada.

This example is based on *Velcro Canada Inc. v. The Queen*,[10] which the government unsuccessfully argued on the basis that the intermediary corporation, a resident in the Netherlands, was not the beneficial owner of the royalties paid by Velcro Canada.

A relevant question about this scenario, which the example does not address, is who owns Aco.[11] Arguably, the outcome under the proposed anti-treaty-shopping rule should be different if Aco were wholly owned by an individual resident in a non-treaty country than if Aco's parent were a public corporation resident in a treaty country (a much more likely scenario). This question highlights the need for a predictable derivative benefit rule that carves out holding or financing structures that, when looked at in the context of the entire group structure, may be tax motivated but are not intended to produce a Canadian treaty benefit, because the ultimate parent would be eligible for equivalent treaty benefits if the impugned payment were made directly to it. It would be too burdensome for taxpayers to have to rebut the conduit presumption and prove that none of the purposes of the structure was to obtain Canadian treaty benefits, because if the payments were made to the ultimate parent of the group, equivalent treaty benefits would be available.

The need for some derivative benefit rule is particularly obvious in the Canada-U.S. context. Assume two U.S. residents and qualifying persons are members of a fiscally transparent limited liability company that has investments around the world, including the shares in a wholly owned Canadian unlimited liability company (ULC). In this scenario, Article IV(7)(b) of the Canada-U.S. tax treaty unjustifiably denies treaty benefits to dividends and other payments from the ULC to the LLC.[12] Historically, the Canada Revenue Agency accepted that if a Luxembourg Sarl were interposed between an LLC and a ULC, treaty benefits under the Canada-Luxembourg tax treaty would be available, thus effectively curing the anomaly of the Canada-U.S. tax treaty. However, at the 2013 meeting of the Canadian branch of the International Fiscal Association, the CRA warned that in light of the 2013 budget, ''taxpayers should not expect the Income Tax Rulings Directorate to look favourably upon a ruling request involving an interposing entity located in a third jurisdiction designed to avoid the application of paragraph (7) of Article IV of the Treaty.'' Absent some form of look-through rule, the proposed anti-treaty-shopping

---

[10]2012 TCC 57. *See generally* Kandev and M. Peters, ''Treaty Interpretation: The Concept of 'Beneficial Owner' in Canadian Tax Treaty Theory and Practice,'' *Report of Proceedings of the Sixty Third Tax Conference, 2011 Tax Conference* (Toronto: Canadian Tax Foundation, 2012), at 26:1-60.

[11]*See* discussion in R. Couzin, ''A Few Thoughts on Treaty Shopping,'' 61 *Can. Tax J.* (2013), 671-676, at 673.

[12]*See* Kandev, ''Article IV(6) and LLCs,'' *Canadian Tax Highlights*, Vol. 18, No. 3 (2010), 2-3.

rule would a priori deny this simple ''self-help'' solution in an innocent situation.

Under Example 1, the government also comments that if, instead, only 45 percent of the royalties received by Bco were used to pay an amount to Aco, the conduit presumption would not apply, and it would be a question of fact whether the main purpose provision would apply. Apparently this is because the ''primarily'' requirement in the conduit presumption would not be satisfied. The question remains whether the conduit presumption would apply to a distribution ''at any time'' in the future of the retained funds or any substituted property. Assume, for example, that upon receipt, 55 percent of the royalties were invested by Bco in securities that were liquidated at a profit a year later, at which time the entire proceeds were distributed to Aco. Query whether the traceability link between the initial relevant treaty income and the ultimate distribution in this example would be broken.

Example 2

In the second example, a treaty-resident company, Bco, must immediately distribute all dividends received from a wholly owned Canadian corporation, Canco, to its two parent companies, Aco and Cco, each resident in a jurisdiction with less favorable treaty withholding tax rates than Bco.

The government comments on this example that the dividends to Bco would be caught by the conduit presumption but that if Aco and Cco are taxable in State A and State C, respectively, on the dividend they received from Bco,[13] it may be reasonable in the circumstances under the relieving provision to provide the benefits that Aco and Cco would have been entitled to under the tax treaty between Canada and states A and C had the dividend they received been paid directly from Canco.

This example is based on *Prévost Car Inc. v. The Queen*,[14] Canada's first beneficial ownership case, which the government lost.

This example highlights several problems with the proposed anti-treaty-shopping rule. First, in *Prévost Car* the structure, which saw a Swedish and a U.K. company form a Dutch company to acquire and own the Canadian target, arguably did not have as its main purpose to obtain a Canadian tax treaty benefit, though ensuring optimal tax treatment was likely an important secondary intention. It is only normal for two companies resident in different countries to choose a joint venture vehicle resident in a neutral jurisdiction.[15] However, the confusing reference to ''one of the main purposes'' in the proposed anti-treaty-shopping rule creates uncertainty for taxpayers in primarily commercially driven cases like *Prévost*. The proposed purpose test seems designed to allow the government to argue that even if the structure had a primary bona fide commercial purpose, somehow it also had as ''another main purpose'' obtaining treaty benefits.

Second, assuming that the structure in *Prévost* was primarily intended to obtain a Canadian tax treaty benefit, this example highlights the need for an abuse test in the government's proposed anti-treaty-shopping rule. In *Prévost* the acquisition of the Canadian target was done in the mid-1990s after Canada had recently changed its tax treaty policy regarding intercorporate dividends to provide a low 5 percent rate. At that time, the Canada-Netherlands tax treaty had already been modified to provide for this rate, while Canada's treaties with Sweden and the U.K. were not yet renegotiated. Nothing indicated that Canada's treaty policy would be different for these two countries and, in fact, the relevant treaties were ultimately changed in line with this policy. Hence, if the objective of using a Dutch joint venture company were treaty shopping, such planning was not abusive, but to the contrary was merely ''self-help'' intended to achieve a result consistent with Canada's current tax treaty policy. An abuse test would rightly save this structure even if it were caught by the purpose test.

Example 3

In the third example, a parent company resident in a non-treaty jurisdiction, Aco, owns shares of a Canadian company, Canco, which it intends to sell. The capital gain realized on the sale of the Canco shares would be subject to tax in Canada.[16] Aco continues its corporate existence to a jurisdiction, State B, with which Canada has a treaty that provides an exemption from Canadian tax on such a disposition.

The government comments that because the proceeds of disposition remain with Aco, the conduit presumption would not apply. However, the main purpose provision would apply because, based on these facts and in the absence of other circumstances, it is reasonable to conclude that one of the main purposes of the continuation of Aco to State B was to obtain the benefit of the capital gains exemption provided under the

---

[13]It is unclear why taxability in Aco's and Cco's countries of residence is relevant. In many countries, dividends in this scenario would be eligible for a participation exemption. The only relevant matter should be liability to tax for treaty residence purposes.

[14]2009 FCA 57 *aff'g* 2008 TCC 231. *See* Kandev, ''*Prévost Car*: Canada's First Word on Beneficial Ownership,'' *Tax Notes Int'l*, May 19, 2008, p. 526; N. Boidman and Kandev, ''Canadian Taxpayer Wins *Prévost* Appeal,'' *Tax Notes Int'l*, Mar. 9, 2009, p. 862.

[15]*See* ''Here, There and Everywhere: Why Some Businesses Choose Multiple Corporate Citizenships,'' *The Economist*, Feb. 22, 2014: ''The Netherlands is sometimes chosen as an acceptably neutral jurisdiction when firms from different countries tie the knot but national pride dictates that neither can move to the other's patch.''

[16]Presumably because the shares meet the definition of taxable Canadian property.

relevant tax treaty. The government goes on to observe that if, instead of becoming a resident of State B shortly before the sale, Aco was already a resident of State B at the time of the initial acquisition of the shares of the Canadian corporation, it would need to be determined whether is it reasonable to conclude that one of the main purposes for the establishment of Aco as a resident of State B was to obtain the capital gains exemption under the tax treaty between Canada and State B. This is a question of fact and all the relevant circumstances would need to be considered, including, for example, the lapse of time between the establishment of Aco in State B and the realization of the capital gains, and any other intervening events.

This example is based on Canada's first treaty shopping case, *MIL (Investments) SA v. Canada*.[17] In this case the government challenged the transactions at issue on the basis of the GAAR, which had been amended retroactively to attack avoidance transactions abusing Canada's tax treaties. The decision in this case has generally been seen as very taxpayer-friendly. The Tax Court of Canada found that the case did not involve avoidance transactions at all because the continuance of the taxpayer from the Cayman Islands to Luxembourg was done in order to allow it to carry on mining projects in Africa. The Tax Court of Canada further held in *obiter* that the transactions were not abusive. The Federal Court of Appeal affirmed this decision without disturbing the lower court's analysis.

Arguably, this example provides insight in the apparent rationale for the government's current anti-shopping proposal. *MIL* may be seen as having set off the chain of events that led to the government's anti-treaty-shopping initiative. The taxpayer-friendly dicta in *MIL* seem to have discouraged the government from pursuing the logical course of attacking abusive treaty shopping cases under the GAAR and to have motivated the government's subsequent misguided reliance in *Prévost* and *Velcro* on the OECD's distorted interpretation of the treaty beneficial owner concept. This strategy has been a failure and probably explains the government's apparent motivation to enact a domestic specific antiavoidance rule that does not contain an abuse test and that relies for its application on a low-threshold ''one of the main purposes'' test aided by an expansive conduit presumption. This is unfortunate because it exposes taxpayers to a high level of uncertainty while effectively allowing tax auditors to freely attack almost any transaction that may involve a treaty benefit.

Example 4

In the fourth example, a widely held mutual fund trust, B-trust, is resident in a jurisdiction with which Canada has a tax treaty. The trust manages a diversified portfolio of investments and holds 10 percent of its portfolio in shares of Canadian companies, for which it receives dividends. Under the treaty with Canada, a reduced rate of withholding tax applies to the dividends. The trust distributes all of its income to its investors annually. The majority of the investors in the trust are residents of countries with which Canada does not have a tax treaty.

The government comments on this example that because dividends received by B-trust from Canadian corporations are primarily used to distribute income to persons not entitled to tax treaty benefits, it would be presumed under the conduit presumption that one of the main purposes for B-trust to undertake its investments in Canadian corporations and for third-state investors to undertake their investments in B-trust, either alone or as part of a series of transactions, was to obtain the benefit under the tax treaty between Canada and B-trust's state of residence. The government states that to rebut this presumption, it would have to be clearly established that none of the main purposes for undertaking these investments, either alone or as part of a series of transactions, was to obtain the benefit of the relevant tax treaty. Investors' decisions to invest in B-trust are not driven by any particular investments made by B-trust, and B-trust's investment strategy is not driven by the tax position of its investors. In this example, and in the absence of other circumstances, there would be sufficient facts to rebut the above presumptions. It follows that the main purpose provision would not apply to deny the tax treaty benefit.

Despite the favorable conclusion reached by the government, this example highlights the potential overreach of the conduit presumption. It is surprising that a diversified and widely held foreign mutual fund would have to consider an anti-treaty-shopping rule and, adding insult to injury, must suffer through the exercise of rebutting the conduit presumption in the hope of acceding to Canadian treaty benefits. It is not hard to see how the proposed anti-treaty-shopping rule can turn into a tool for taxpayer abuse and ultimately drive away investment by foreign collective investment vehicles.

Example 5

In the fifth example, a corporation, Aco, resident in a country with which Canada does not have a treaty, owns all the shares of a financing company, Finco, that is resident in a country that has a treaty with Canada. Finco finances Aco's wholly owned subsidiaries, including a Canadian company, Canco, and a company that is resident in the same country as Finco, Bco. The active business carried on by Bco is substantial in comparison to the activities carried on by Canco. Aco's other treaty subsidiaries are residents of countries that provide equivalent benefits for withholding tax on interest as those provided under the treaty between Canada and Finco's country of residence. Finco reinvests its profits from the interest payments received from the various subsidiaries.

[17]2007 FCA 236, *aff'g* 2006 TCC 460.

The government states that because the interest payments received by Finco from Canco are primarily used to pay an amount to persons that would have been entitled to an equivalent benefit had they received the interest payment directly from Canco, the conduit presumption would not apply. Further, the government states that because Bco carries on a substantial active business in State B and is related to Finco, it would be presumed under the safe harbor presumption that none of the main purposes for Finco to undertake the investment in Canada was for Finco to obtain the benefits of the tax treaty between Canada and State B.

Despite the favorable conclusion of the government in this instance, Example 5 highlights how uncertain Canadian treaty benefits would be under the proposed anti-treaty-shopping rule. Considering the breadth of the expression ''used to pay, distribute or otherwise transfer, directly or indirectly, at any time or in any form, an amount to another person or persons'' in the proposed overriding conduit presumption, it is uncertain whether Finco can ever pay dividends or otherwise transfer money to its non-treaty-country parent, Aco. In fact, conceptually, an intermediary entity in a multinational group is bound to sooner or later transfer its assets to its parent. The proposal seems to allow the CRA to trace the source of subsequent payments to Aco to interest payments received by Finco from the Canadian company, such that the conduit presumption would be triggered to retroactively deny treaty benefits. Because the conduit presumption overrides the safe harbor presumption, that Bco carries on a substantial business in State B is irrelevant.

The Missing Example

An obvious factual situation missing from the set of examples provided by the government in the budget is that of a standard private equity investment in a Canadian target. Assume a private equity fund organized as a limited partnership formed under Cayman Islands law. Most investors in the private equity fund are state-owned entities (both from treaty and non-treaty countries), pension funds, and university endowments. A minority of investors in the private equity fund includes taxable persons, a small part of whom are residents in non-treaty countries. The private equity fund interposes a Luxembourg ''blocker'' corporation to acquire, finance, and hold a Canadian target. All payments from the Canadian target to its Luxembourg parent are transferred to the private equity fund and ultimately to the fund's investors.

The primary concern with the above situation is the possible application of the conduit presumption. Although the Luxembourg blocker may have tax planning objectives (such as interest stripping), its purpose from a treaty perspective would likely be purely administrative — that is, to avoid the necessity of applying Canada's domestic tax law and tax treaties through the private equity partnership to the ultimate investors. Such investors may be eligible for a variety of tax treatments. One category may claim sovereign immunity outside the ambit of a treaty; another may be eligible for a treaty exemption allowed to sovereign investors, pension plans, or charities[18]; a third category may be eligible for varying treaty-reduced rates[19]; finally, a fourth category would not be eligible for treaty benefits. The treaty rate applicable to the Luxembourg blocker may be an adequate approximation of the blended Canadian withholding tax rate that would be applicable in respect of the private equity limited partners. Unfortunately, the government's anti-treaty-shopping proposal raises the specter of the CRA challenging Canadian treaty benefits to the Luxembourg company and requiring extensive evidence of the Canadian tax treatment applicable to each limited partner of the private equity fund. As private equity funds are notoriously reluctant to release details on their investors to tax authorities,[20] satisfactory proof of treaty benefits may be hard to produce.

Administration and Enforcement

As with most things, the devil will be in the details of the administration and enforcement of the proposed anti-treaty-shopping rule. Significantly, final withholding taxes, such as those imposed under Part XIII of the ITA, and non-final withholding taxes, such as that under section 116, are effectively a self-policing mechanism that encourages the payer to be prudent in complying with its obligations under the ITA. Because of this and although the government's main targets are wholly owned treaty-shopping structures, where the proposed rule could turn out to be hellish is in arm's-length scenarios. Despite the government's favorable comments to Example 4, the way the anti-treaty-shopping rule would likely play out in practice is that the Canadian company would retain the full unreduced 25 percent on dividends to B-trust. The investee company would not take up the risk of deciding whether B-trust would ultimately be eligible for treaty benefits in light of the anti-treaty-shopping rule. Hence, B-trust would be forced to seek a withholding tax refund. Considering this, in practice, the proposed anti-treaty-shopping rule would have a highly dissuasive effect on inbound investment.

Conclusion

Despite its vast territory, Canada has a relatively small population of only 35 million and, accordingly, its GDP (PPP) of some $1,474 billion is over 10 times smaller than that of its main trading partner, the U.S.;

---

[18]*See* Article XXI of the Canada-U.S. tax treaty.

[19]*E.g.*, some Canadian treaties provide for a low 5 percent rate on dividends, whereas other Canadian treaties only apply a 15 percent dividend withholding rate.

[20]Sometimes the fund governing documentation would actually prohibit such release.

over eight times smaller than that of China; and half that of Germany.[21] Considering that Canada is a relatively small market and capital pool, it has been consistent Canadian tax policy to encourage both inbound investment by nonresidents into Canada and outbound investment by Canadian businesses abroad. As part of this policy, over the years Canada has actively pursued the conclusion of comprehensive tax treaties, and, as the government rightly brags in the 2014 budget, now has 92 tax treaties in force and three tax treaties signed but not yet in force. With one of the largest treaty networks in the world, including treaty partners such as Barbados and Luxembourg, Canada historically has never taken a hard stance against treaty shopping. This is logical as it can be assumed that with such a significant number of treaties, the incidence of abusive treaty shopping should be minimal. It is only recently and possibly under influence from the OECD that Canada began challenging perceived treaty shopping cases (some of which, as noted above, are very benign).

The domestic anti-treaty-shopping rule proposed in the 2014 budget would be an extensive rule that arguably would go beyond curtailing abusive treaty shopping (or any treaty shopping) and would directly or indirectly limit Canadian tax planning opportunities for nonresidents investing in Canada. Of course, it is trite to say that adopting higher taxes on nonresident investors in Canada (what the proposed rule amounts to) is within Parliament's power, but the general discomfort with the treaty shopping proposal is caused by the fact that, beside the OECD-inspired generalizations, the government has put forward very little in terms of in-depth economic cost benefit analysis. It is hoped that the Canadian government would not take any precipitated action on treaty shopping that causes a major disincentive to inbound capital flows. ◆

[21]Numbers based on 2012 IMF statistics. For that year, U.S. GDP was $16,244 billion, Chinese GDP was $12,261 billion, and German GDP was $3,167 billion. These are the main countries that traditionally or more recently have taken a hard stance on treaty shopping.