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FEATURED PERSPECTIVE

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Canada has been concerned about treaty shopping for some time and accordingly has been involved in and a supporter of the anti-treaty-shopping recommendations in action 6 of the OECD's base erosion and profit-shifting project. In this article, the authors examine the extent to which Canada's new treaties with Taiwan and Israel reflect that involvement and concern.

In the year since the final reports of the OECD's base erosion and profit-shifting project were released and approved by the G-20, Canada has signed new income tax treaties with Taiwan[1] and Israel.[2] That makes it timely to consider the extent to which Canada's post-BEPS treaties reflect the BEPS recommendations, which Canada helped to develop.

This article deals with that question in two parts: first, regarding the treaty shopping rules proposed in action 6, and second with the other treaty rules proposed in action 7; in both cases, thought will be given to how the action 15 multilateral instrument (not yet released) could affect Canada's two post-BEPS treaties and those that came before.

Part 1 — Treaty Shopping

Background

On February 12, 2013, the BEPS project was launched by the G-20 and the OECD and was put into motion on July 19 of that year by the issue of an "Action Plan on Base Erosion and Profit Shifting."[3]

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[1] *See* "Arrangement Between the Canadian Trade Office in Taipei and the Taipei Economic and Cultural Office in Canada for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income," signed on Jan. 18, 2016. (The unusual styling obviously reflects the particular status of Taiwan in relation to the People's Republic Of China, with which Canada has a conventional tax convention (which is currently under renegotiation).) The arrangement (referred to herein as a treaty) will enter into effect the year following ratification and offers:

(Footnote continued in next column.)

- 10 percent tax on dividends paid to 20 percent or greater corporate shareholders and 15 percent in other cases;
- 10 percent tax on interest;
- 10 percent on royalties but without the exemptions of the type seen in most recent Canadian treaties and referred to in the next footnote; and
- exemptions for some capital gains.

[2] *See* "Convention between the Government of Canada and the Government of the State of Israel for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income," signed on Sept. 21, 2016. The treaty will enter into effect the year following ratification and offers:

- 5 percent tax on dividends paid to 25 percent or greater corporate shareholders and 15 percent in other cases;
- 10 percent tax on interest;
- 10 percent on royalties with exemption for royalties related to specific copyrights, computer software, patents, and information related to industrial, commercial, or scientific experience; and
- exemptions for some capital gains.

[3] For a discussion, see Boidman and Kandev, "BEPS: The OECD Discovers America?" *Tax Notes Int'l*, Dec. 16, 2013, p. 1017.

Action 6 of the plan calls for the development of model treaty provisions and domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. This would also seek to clarify that tax treaties are not intended to be used to generate double nontaxation and to identify the tax policy considerations that countries generally should consider before deciding to enter into a tax treaty with another country.

This agenda seems anything but new. The action plan referred to the 2003 commentary to article 1 of the OECD model, which in paragraphs 7 to 26 exhaustively addresses ''Improper use of the Convention.'' The OECD had by that time also given an antiabuse spin to many other areas of the commentary. For example, much effort was invested into transforming the beneficial owner concept in treaty articles 10, 11, and 12 into an anti-treaty-shopping tool.[4] The OECD's work in this area had already encouraged a general move against treaty shopping, whether in the form of court challenges, domestic-specific or general antiavoidance rules, or treaty limitation on benefits provisions. Though it seemed unlikely that radically new ideas in this area would spring from the BEPS project, its momentum could accelerate this process.

On August 12, 2013, Canada issued a consultation paper on treaty shopping.[5] The stated intention of the consultation process was to examine a range of possible approaches to address the practice of treaty shopping into Canada. Significantly, the paper stated explicitly for the first time that ''Canada participates actively in the work of the OECD pertaining to the Model Tax Convention and supported the development of the OECD Commentary on the improper use of treaties.'' The consultation paper proceeded to lead the reader in the direction of what then seemed to be the government's apparent predilection for a domestic anti-treaty-shopping provision. But, as discussed below, this notion has been abandoned.

There was an important twofold context to the foregoing. First, the Canadian interest in fighting perceived treaty shopping started long before BEPS, and indeed the August 2013 consultation process had been fueled by government losses in the three cases on this point it had taken to court.[6] Second is that nobody has anything to teach the U.S. — the creator of the comprehensive LOB — about how to combat treaty shopping.

BEPS

On October 5, 2015, the OECD released final reports (except as noted above regarding action 15) comprising its recommendations to combat BEPS and categorized them — in terms of expectation of adoption by the G-20 and other countries that have joined the project — as follows: those that are new minimum standards, those that revise existing standards, those that are common approaches that will facilitate the convergence of national practices, and those that provide guidance drawing on best practices. The first category is, according to the reports, the object of a commitment of all OECD and G-20 countries to consistent implementation.[7]

The action 6 report recommended (as a ''minimum standard'') three possible types of changes to tax treaties to deal with treaty shopping.[8] One change would see the inclusion of a clear, yet fairly innocuous, statement that the states that enter into a tax treaty intend to avoid creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. A second possible change, to be included in the OECD model tax treaty, would be the inclusion of a U.S.-style LOB rule that limits the availability of treaty benefits to entities that meet specific conditions.[9] Finally, another possible modification, to be inserted in the OECD model tax treaty, is the inclusion of a general antiabuse rule based on the principal purposes of transactions or arrangements (the PPT rule) in order to address other forms of treaty abuse, including treaty shopping situations that would not be covered by an LOB rule.[10]

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

[5] *See* Canada, ''Consultation Paper on Treaty Shopping — The Problem and Possible Solutions'' (Aug. 12, 2013). The first section of the consultation paper defined treaty shopping. The second section set out Canada's position on treaty shopping, and the third section discussed recent judicial experience. The fourth section described the evidence of treaty shopping, and the fifth section explained unintended consequences of treaty shopping. The sixth section canvassed the possible approaches to preventing treaty shopping. The seventh section explored approaches for striking a balance between general and specific rules. The eighth section concluded with a description of the consultative process. Finally, the ninth section summarized questions and issues on which the government invites stakeholders' comments. This followed from the 2013 federal budget.

[6] *MIL (Investments) v. Canada*, 2006 D.T.C. 3307 (TCC), *aff'd* 2007 D.T.C. 5437 (FCA); *Prévost Car v. The Queen*, 2009 D.T.C. 5053, *aff'g* 2008 D.T.C. 3030; *Velcro Canada Inc. v. R.*, 2012 TCC 57 (Feb. 24, 2012) (TCC).

[7] *See* OECD, http://www.oecd.org/tax/beps-2015-final-reports.htm; and Boidman and Kandev ''BEPS: A Spent Force or Radical Change?'' *Tax Notes Int'l*, Dec. 7, 2015, p. 837.

[8] *See* Executive Summaries, *supra* note 7 at p. 21-22. Significantly, these changes are not proposed to be included in domestic anti-treaty-shopping legislation.

[9] These conditions, which are based on the legal nature, ownership in, and general activities of the entity, seek to ensure that there is a sufficient link between the entity and its state of residence. Such LOB provisions are currently found in treaties concluded by a few countries, most notably the U.S.

[10] Under that rule, if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits

(Footnote continued on next page.)

The minimum standard agreed to by all G-20/OECD countries is to be implemented by countries by including in their tax treaties the general anti-shopping statement of intention — and at their option, including in their treaties either:

- the combined approach of an LOB and PPT rule;
- the PPT rule alone; or
- the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

In other words, the OECD's formulation of the minimum standard effectively avoided setting a single common standard for combating treaty shopping. This opened the door to obviously problematic situations: leaving aside the possible contents of the action 15 multilateral instrument and which countries might sign on to it, it is only when two countries do agree on the choice of the foregoing options that there will be the touted ''agreement on minimum standards'' to seek to counter so-called treaty shopping.[11]

When the October 5, 2015, report came out, it seemed evident that action 6 was the only substantive BEPS item likely to get traction in Canada, given the 2013 budget, the 2013 consultation paper, and (despite opposition from the Canadian tax community) the 2014 budget,[12] in which the Department of Finance proposed adopting a PPT-type domestic anti-shopping treaty override. But then in August 2014 the government had announced it would not proceed until the OECD's BEPS work was complete.

With the October 5, 2015, BEPS proposals short-listing treaty shopping among the four minimum standards, the March 22, 2016, budget confirmed the government's commitment to address treaty abuse in accordance with the BEPS proposals. According to the budgetary materials, Canada will consider using either the LOB article or PPT approach to address treaty shopping, depending on the particular circumstances. Budget 2016 notes that amendments to Canada's tax treaties to include a treaty antiabuse rule could be achieved through bilateral negotiations, the multilateral instrument that will be developed in 2016, or a combination of the two.[13]

Significantly, the budget 2016 announcements abandoned the government's initiative presented in budget 2014 to adopt a domestic anti-treaty-shopping rule that would serve as a treaty override. Budget 2016 also suggests that Canada won't be using the OECD's preferred approach of including both an LOB article and a PPT rule in its treaties but said Canada's anti-treaty-abuse strategy may be implemented through the action 15 multilateral instrument.

Where Do the New Treaties Fit?

In the context of the foregoing background and evolution of anti-treaty-shopping initiatives and, in particular, the final BEPS reports and the 2016 Canadian federal budget, where do Canada's post-BEPS treaties with Israel and with Taiwan fit in? To what extent, if any, do they adopt and reflect the action 6 ''minimum'' anti-treaty-shopping standards?

In a nutshell, they do not directly, but do, in part, indirectly. Neither contains the recommended ''clear statement'' that the parties intend to avoid creating opportunities for nontaxation or reduced taxation, an LOB rule, or a general PPT rule. However, both include ''mini'' PPT rules in the provisions (articles 10, 11, and 12) that grant reduced withholding tax on dividends, interest, and royalties (an approach seen in pre-BEPS Canadian treaties, such as that with the U.K.). For example, article 10 of the new treaty with Israel states:

> A resident of a Contracting State shall not be entitled to any benefits provided under this Article in respect of a dividend if one of the main purposes of any person concerned with an assignment or transfer of a dividend, or with the creation, assignment, acquisition or transfer of the shares or other rights in respect of which the dividend is paid or with the establishment, acquisition or maintenance of the person that is the beneficial owner of the dividend, is for that resident to obtain the benefits of this article.

Virtually identical language is seen in the aforementioned articles and there is similar language in the capital gains article (article 13(7)) of the Israel treaty but not the Taiwan treaty.

Separately, the Taiwan treaty has a special regime provision (in article 26(3) and seen in prior Canadian treaties) that reads, in part, as follows:

> The Arrangement will not apply to any company that is resident of a territory, and is beneficially

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would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty.

[11]But treaty shopping should conceptually be an increasingly smaller problem in light of the proliferation of tax treaties that are largely harmonized on the basis of the OECD model. There are currently more than 3,500 bilateral tax treaties.

[12]*See generally* Kandev, ''Canada Intent on Stoppin' the Shoppin' and More,'' *Tax Notes Int'l*, Mar. 31, 2014, p. 1201. Regarding the expression ''one of the main purposes,'' see Boidman, '''One of the Main Purposes' Test,'' 22 *Canadian Tax Highlights* 9 (May 2014).

[13]*See* Boidman and Kandev, ''Canada Takes First BEPS Steps,'' *Tax Notes Int'l*, April 25, 2016, p. 371.

owned by one or more persons who are not resident of that territory if the tax imposed on the company (by that territory) is substantially lower than the amount that would be imposed if all the shares of the company were beneficially owned by individuals resident of that territory.

The Israel treaty seeks to emulate Article XXIX A(7) of the Canada-U.S. treaty by incorporating domestic antiavoidance rules, with the following language in article 25:

> Nothing in this Convention shall prevent a Contracting State from applying any provision of its laws which are designed to prevent avoidance or evasion of taxes.

Fortunately, for those who are troubled by the notion, central to the BEPS PPT, that there can never be more than one principal purpose (or reason) for a transaction, the basic effect of article 25 would be to bring Canada's general antiavoidance rule (section 245 of the act) into play, and that operates on the premise of a ''primary'' purpose — effectively therefore a ''principal purpose,'' not ''one of the principal purposes.''[14]

What should be read into the omission in these two post-BEPS treaties of the key ''minimum standards'' of article 6? Is it simply a matter of their terms having been negotiated before October 5, 2015, even though they were signed after? The fact that the Israel treaty was accompanied by a protocol may put this explanation into question. Or is it a matter of the parties intending to buy into the multilateral instrument of action 15 that will presumably feature the action 6 proposals? It is difficult, in light of the absolute lack of precedent for this matter, to venture an informed guess.

Part 2 — Other Treaty Matters

Background

Aside from the action 6 anti-treaty-shopping proposals, treaty-related BEPS recommendations are seen in action 2 (hybrid arrangements), action 7 (artificial avoidance of PE status), and action 14 (dispute resolution).

Part II of action 2 proposes tax treaty changes targeted at ensuring that hybrid instruments and entities, as well as dual resident entities, are not used to obtain unduly the benefits of tax treaties and that tax treaties do not prevent the application of the changes to domestic law recommended in Part I of action 2.

Action 7 focuses on changes to the PE definition intended to eliminate the avoidance of PE nexus through the use of commissionnaire arrangements and the fragmentation of business activities.

The action 14 work on dispute resolution identifies the following elements of a minimum standard to ensure the timely, effective, and efficient resolution of treaty-related disputes:

- full implementation in good faith of treaty obligations related to the mutual agreement procedure (MAP) and resolution of MAP cases in a timely manner;
- establishment of administrative processes promoting the prevention and timely resolution of tax treaty-related disputes; and
- establishment of access to MAP by taxpayers.

In parallel, a large group of countries has committed to move quickly toward mandatory and binding arbitration.[15]

Where Do the New Treaties Fit?

Neither the new Israel nor Taiwan treaty make specific reference to or reflect the BEPS recommendations in actions 2, 7, or 14. But, again, it remains to be seen whether those actions, in whole or in part, will be imported into these treaties through the action 15 multilateral instrument process.

The Multilateral Instrument

As noted above, there are now more than 3,500 bilateral tax treaties, and obviously the OECD would like to see all treaty changes and additions adopted by all concerned. Given the impossibility of quickly renegotiating so many treaties, action 15 seeks the development of a multilateral instrument that sets out as many of the recommendations raised as a large number of countries would all agree to and then would have those countries adopt the instrument as part of all of their treaties.

As noted earlier, it is questionable whether Canada will sign on given the cost — namely, the loss of bargaining chips for the sake of overall design and balance of bilateral tax treaties. Also, because tax treaties affect government revenue and thus must be adopted by Canada's Parliament, it is assumed that the instrument would require parliamentary enactment. It remains to be seen whether that would raise novel issues.

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[14]For a discussion, see Boidman, *supra* note 12.

[15]Albania, Argentina, Australia, Austria, Azerbaijan, Bangladesh, Belgium, Brazil, Canada, Chile, Colombia, Costa Rica, the People's Republic of China, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Mexico, Morocco, the Netherlands, New Zealand, Nigeria, Norway, Peru, the Philippines, Poland, Portugal, the Russian Federation, Saudi Arabia, Senegal, Singapore, the Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Tunisia, Turkey, the United Kingdom, the United States, and Vietnam.

Therefore, it is questionable whether this process will add BEPS recommendations to Canada's new treaties with Israel and Taiwan.

Concluding Comments

There appears to be a direct link between the content of Canada's first two post-BEPS treaties and the theme of a commentary by these writers on BEPS published in December 2013, ''BEPS: The OECD Discovers America?'' (see *Tax Notes Int'l*, Dec. 16, 2013, p. 1017).

It is evident from the provisions of the Israel and Taiwan treaties that the Canadian government is comfortable with the protection of Canada's tax base against treaty shopping and other treaty planning afforded by rules it has developed and used in several pre-BEPS treaties. There are the ''mini PPT'' rules in several articles in both treaties, the special regime rule seen in the Taiwan treaty, and the retention of domestic antiavoidance rules seen in the Israel treaty.

Significantly, these treaties don't include an LOB or general PPT rule or any special PE or hybrid rules. (Hybrid rules are seen in only one Canadian treaty — that with the U.S., and that was undoubtedly driven by the almost-unique-to-the-U.S. domestic hybrid entity rules.)

The foregoing reflects the theme of our December 2013 *TNI* commentary, namely that there basically is nothing in international tax planning and related tax avoidance techniques that governments of countries such as Canada and the U.S. have not seen before and need to learn from the OECD. And, as a result, it is doubtful that the BEPS project would add much to the substantive law governing domestic and treaty objectives.

We acknowledge, however, that the picture will be incomplete until we see whether and how Canada participates in the action 15 multinational instrument and the content of further post-BEPS treaties becomes known. ◆