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Tax Treaty Abuse and the Principal Purpose Test: Part II

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Part II

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Abstract

The Multilateral Convention to Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting or Multilateral Instrument (MLI) has been described as "an historical turning point in the area of international taxation" which introduces a third layer of tax rules for the taxation of cross-border transactions in addition to domestic tax law and bilateral tax treaties. Of the many provisions of the MLI, the most important are the preamble text in Article 6(1) and the so-called principal purpose test (PPT) in Article 7(1), both of which have been adopted by all signatories to the MLI in order to satisfy the OECD's minimum standard on tax treaty abuse under BEPS Action 6. This two-part article considers the structure and potential application of the PPT in the context of pre-BEPS responses to perceived tax treaty abuses, the OECD's work on BEPS Action 6, and other provisions of the MLI including the preamble text in Article 6(1). The first part, in the previous issue of the Journal, reviewed pre-BEPS responses to perceived tax treaty abuses, providing necessary background and context for understanding BEPS Action 6, the MLI and the PPT. The second part, in this issue of the Journal, examines the PPT in light of this background and in the context of BEPS Action 6 and other provisions of the MLI, considering its relationship to other anti-avoidance doctrines, principles and rules, the various elements that comprise its basic structure, the kinds of transactions or arrangements to which it may be expected to apply, and the consequences of its application.

Introduction

The first part of this article examined pre-BEPS responses to perceived tax treaty abuses, reviewing domestic and treaty-based responses to tax treaty shopping

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and other perceived treaty abuses in order to provide background for understanding BEPS Action 6, MLI provisions aimed at preventing tax treaty abuses, and the principal purpose test (PPT) in particular.[1] The second part of this article examines the PPT in light of this background and in the context of BEPS Action 6 and other provisions of the MLI, considering its relationship to other anti-avoidance doctrines, principles and rules, the various elements that comprise its basic structure, the kinds of transactions or arrangements to which it may be expected to apply, and the consequences of its application.

Part II. BEPS Action 6, the MLI and the Principal Purpose Test

As the first part of this article explained, the OECD and its member states relied on various approaches to discourage tax treaty shopping and other perceived tax treaty abuses prior to BEPS Action 6 and the MLI, including domestic anti-avoidance doctrines and statutory general anti-avoidance rules, the concept of an implicit anti-abuse principle, the beneficial ownership requirement, and specific anti-avoidance rules in domestic law and tax treaties. In practice, however, these approaches have been inconsistently adopted and applied. As well, the 2014 revisions to the OECD Commentaries confirm that the beneficial owner concept should be narrowly interpreted and does not address all forms of tax treaty shopping.[2]

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[1] David G. Duff, "Tax Treaty Shopping and the Principal Purpose Test – Part 1" (2018), 66:3 *Can. Tax J.* 1-57.

[2] Paragraph 12.6 of the commentary on article 10 of the OECD model convention; paragraph 10.4 of the commentary on article 11 of the OECD model convention; and paragraph 4.5 of the commentary on article 12 of the OECD model convention.

For these reasons, it is perhaps not surprising that the OECD's Action Plan on Base Erosion and Profit Shifting identified treaty abuse as "one of the most important sources of BEPS concerns" and that BEPS Action 6 was specifically mandated to "develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances" and to "clarify that tax treaties are not intended to be used to generate double non-taxation."[3] Before examining the PPT in detail, it is useful to review the main recommendations of BEPS Action 6 and the incorporation of these recommendations into the 2017 OECD model convention and provisions of the MLI.

A. BEPS Action 6 and the MLI

Although the Final Report of BEPS Action 6 devotes some attention to domestic anti-abuse rules and their relationship with tax treaties,[4] most of the Report addresses treaty provisions to prevent tax treaty shopping and other treaty abuses,[5] and revisions to the title and preamble of tax treaties to clarify that tax treaties are not intended to be used to generate double non-taxation.[6] Incorporated into the 2017 OECD model convention and various provisions of the MLI, these provisions and revisions are intended to both strengthen treaty-based responses to

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[3] Organization for Economic Cooperation and Development, *Action Plan on Base Erosion and Profit Shifting*, (Paris: OECD, 2013) at 18 and 19 (https://www.oecd.org/ctp/BEPSActionPlan.pdf). BEPS Action 6 was also mandated to "identify tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country."

[4] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, BEPS Action 6: 2015 Final Report, (Paris: OECD, 2015) [hereafter Final Report on BEPS Action 6] at paras. 53-67, (www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm).

[5] *Ibid*. paras.17-52.

[6] *Ibid*. paras. 68-74.

perceived tax treaty abuses and to promote increased consistency in these responses through minimum standards which signatories to the MLI must adopt.

1. Tax Treaty Shopping

Beginning with tax treaty shopping, the Final Report of BEPS Action 6 recommends a "three-pronged approach" comprising the following elements:

- a "clear statement" in tax treaties that "the Contracting States, when entering into a treaty, wish to prevent tax avoidance and, in particular, intend to avoid creating opportunities for treaty shopping";
- inclusion in the OECD model convention of a specific limitation-on-benefits (LOB) provision based on the LOB provisions in tax treaties with the United States; and
- inclusion in the OECD Model of "a more general anti-abuse rule based on the principal purposes of transactions or arrangements".[7]

The first of these "prongs" underlies revisions to both the title and the preamble of the OECD model convention. Unlike the title of the 1963 and 1977 OECD model conventions, which referred only to a convention "for the avoidance of double taxation with respect to taxes on income and on capital", the title of the 2017 OECD model convention refers to a convention "for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance." As well, unlike many tax treaties which refer only to a desire to conclude a convention "for the avoidance of double taxation and the prevention of fiscal

[7] *Ibid*. para. 19.

evasion with respect to taxes on income and on capital," the preamble to the 2017 OECD model conventions states that the contracting states:

> Desir[e] … to further develop their economic relationship and to enhance their co-operation in tax matters, [and]
>
> Intend … to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third states).

According to the Final Report of BEPS Action 6, these revisions build upon earlier statements in the 1977 and 2003 commentaries to the OECD model convention,[8] "provide the clarification required by Action 6,"[9] and "will be relevant to the interpretation and application of provisions" of tax treaties that include this language.[10] According to the commentary on these revisions:

> The changes made expressly recognise that the purposes of the Convention are not limited to the elimination of double taxation and that the Contracting States do not intend the provisions of the Convention to create opportunities for non-taxation or reduced taxation through tax evasion and avoidance. Given the particular base erosion and profit shifting concerns arising from treaty-shopping arrangements, it was also decided to refer explicitly to such arrangements as one example of tax avoidance that should not result from tax treaties, it being understood that this was only one example of tax avoidance that the Contracting States intend to prevent.[11]

The second element of the OECD's "three-pronged approach" to tax-treaty shopping is reflected in the framework for detailed LOB provisions in articles 29(1)-

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[8] *Ibid*. paras. 70-71. According to paragraph 7 of the 1977 commentary on article 1 of the OECD model convention, tax treaties "should not … help tax avoidance or evasion." According to paragraph 7 of the 2003 commentary on article 1 of the OECD model convention, it is "a purpose of tax conventions to prevent tax avoidance and evasion." As explained in the first part of this article, although it is reasonable to conclude that tax treaties are not intended to facilitate tax avoidance, it is less clear whether they are intended to prevent tax avoidance, though it is arguable that provisions for the exchange of information and assistance in the collection of taxes help to prevent tax avoidance as well as tax evasion. Although the amended title of the OECD model convention declares that the convention is "for the" prevention of tax evasion and tax avoidance as well as the elimination of double taxation, the amended preamble language refers to an intention to eliminate double taxation "without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance".

[9] *Ibid*. para. 72.

[10] *Ibid*. para. 73.

[11] Paragraph 16.1 of the commentary on the introduction to the 2017 OECD model convention.

(7) of the 2017 OECD model convention. Similar in structure to the LOB provisions in the 2016 U.S. model convention,[12] these provisions limit otherwise available treaty benefits to qualified persons,[13] "headquarters" companies,[14] income that emanates from or is incidental to the active conduct of a trade or business carried on by a resident of a contracting state who is not a qualified person,[15] income paid to an entity that is not a qualified person if a stipulated percentage of the entity is owned directly or indirectly by equivalent beneficiaries,[16] and treaty benefits granted by the competent authority of the source state.[17] Like the LOB provisions in the U.S. model convention, these provisions are designed to limit treaty benefits to residents of contracting states with substantive economic connections to that state and circumstances where entitlement to treaty benefits does not result from abusive tax treaty shopping.[18] As a result, as the Final Report of BEPS Action 6 explains, these specific anti-avoidance rules target "treaty shopping situations that can be identified on the basis of criteria based on the legal nature, ownership in, and general activities of, certain entities."[19]

While the "objective criteria" of these LOB provisions provide "more certainty" than a general anti-abuse provision like the PPT, the Report continues, they do not address "other forms of treaty abuses" nor all forms of tax-treaty

[12] United States, Department of the Treasury, United States Model Income Tax Convention , February 17, 2016 (www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf). For a brief summary of these provisions, see the first part of this article.
[13] Articles 29(1) and (2) of the OECD model convention.
[14] Article 29(5) of the OECD model convention.
[15] Article 29(3) of the OECD model convention
[16] Article 29(4) of the OECD model convention.
[17] Article 29(6) of the OECD model convention.
[18] See the discussion of these provisions in the first part of this article.
[19] OECD, Final Report on BEPS Action 6, *supra* note 4 at para. 20.

shopping such as conduit arrangements "through which a resident of a Contracting State that would otherwise qualify for treaty benefits is used as an intermediary by persons who are not entitled to these benefits."[20] For these reasons, the third "prong" of the OECD's recommended approach to tax treaty shopping includes a more general anti-abuse provision in the form of a PPT that "incorporates the principles" contained in the commentary to article 1 of the OECD model convention, according to which:

> … the benefits of a tax treaty should not be available where one of the principal purposes of arrangements or transactions is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax treaty.[21]

This general anti-abuse provision is contained in article 29(9) of the 2017 OECD model convention.

Although recommending this "three-pronged approach" to tax treaty shopping, the Final Report of BEPS Action 6 acknowledges that states might have legitimate reasons to depart from this combined approach – for example, where domestic anti-abuse rules or anti-avoidance doctrines make a general anti-abuse rule unnecessary, or administrative capabilities make it difficult to apply detailed LOB provisions.[22] For these reasons, the Report accepts "a certain degree of flexibility" in the approaches that different states may adopt, provided that they

[20] *Ibid*.

[21] *Ibid*. at para. 19, referring to the "guiding principle" in paragraph 9.5 of the commentary on article 1 of the 2003 commentary on the OECD model convention. This "guiding principle" now appears in paragraph 61 of the commentary on article 1 of the 2017 OECD model convention.

[22] *Ibid*. paras. 6 and 21.

"effectively address … treaty abuses along the lines of this report."[23] In the end, therefore, the Report concludes:

> At a minimum, countries should agree to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements … [and] implement that common intention through either the combined approach …, , the inclusion of the PPT rule, or the inclusion of the LOB rule supplemented by a mechanism (such as a treaty rule that might take the form of a PPT rule restricted to conduit arrangements or domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would deal with conduit arrangements not already dealt with in tax treaties.[24]

The various elements of the combined approach as well as these "minimum standards" on treaty abuse are reflected in provisions of the MLI.

The MLI itself is a product of BEPS Action 15, which was mandated to devise a legal instrument to modify existing bilateral tax treaties "in order to swiftly implement the tax treaty measures developed in the course of the OECD-G20 BEPS Project."[25] Consistent with the recommended approach to tax treaty shopping in the Final Report in BEPS Action 6, the MLI includes preamble language corresponding to the amended preamble text of the 2017 OECD model convention,[26] simplified limitation-on-benefits (SLOB) provisions similar to articles 29(1)-(7) of the 2017 OECD model convention,[27] and a general anti-abuse provision like the PPT in article 29(9) of the OECD model convention.[28] Consistent with the "minimum standards" in this Report, signatories to the MLI are required to adopt the amended preamble text

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[23] *Ibid*. paras. 6 and 22.
[24] *Ibid*. para. 22.
[25] OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*, BEPS Action 15: 2015 Final Report, (Paris: OECD, 2015) at 11, available at http://www.oecd.org/tax/developing-a-multilateral-instrument-to-modify-bilateral-tax-treaties-9789264219250-en.htm.
[26] Articles 6(1) and (3) of the MLI. The MLI does not include a provision that would modify the title of CTAs to correspond to the amended title of the 2017 OECD model convention.
[27] Articles 7(8)-(13) of the MLI. Unlike the OECD model convention, however, the SLOB does not include a provision extending treaty benefits to headquarters companies.
[28] Article 7(1) of the MLI.

expressing an intention "to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third jurisdictions)" where such language does not already exist in a CTA.[29] They are also required to implement this intention by adopting the PPT alone where a CTA does not already contain a similar general anti-abuse provision,[30] by adopting the PPT and the SLOB,[31] or by indicating that they intend to adopt a combination of a detailed LOB provision and either rules to address conduit financing structures or a PPT.[32]

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[29] See article 6(2) of the MLI, providing that the preamble text in article 6(1) "shall be included in a Covered Tax Agreement in place of or in the absence of preamble language of a Covered Tax Agreement referring to an intent to eliminate double taxation, whether or not that language also refers to the intent not to create opportunities for non-taxation or reduced taxation," and article 6(4) of the MLI which allows parties to the MLI to reserve the right for article 6(1) not to apply to CTAs "that already contain preamble language describing the intent of the Contracting Jurisdictions to eliminate double taxation without creating opportunities for non-taxation or reduced taxation, whether that language is limited to cases of tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Covered Tax Agreement for the indirect benefit of residents of third jurisdictions) or applies more broadly." In contrast, article 6(3) provides parties to the MLI the right to choose to include preamble text expressing the desire of the contracting jurisdictions "to further develop their economic relationship and to enhance their co-operation in tax matters."

[30] See article 7(15)(b) of the MLI, which permits signatories to reserve the right for article 7(1) not to apply to CTAs that "already contain provisions that deny all of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits."

[31] See article 7(6) of the MLI, which allows parties to the MLI to choose to apply the SLOB. Although this provision states that the SLOB will apply to a CTA only where all parties to the CTA have chosen to apply the provisions, article 7(7)(a) provides that the SLOB may apply asymmetrically where contracting jurisdictions that do not choose to apply these provisions agree to such application by contracting jurisdictions that choose to apply the SLOB. Where parties choose to apply the SLOB, article 7(14) provides that it "shall apply in place of or in the absence of" provisions of a CTA that limit treaty benefits "only to a resident that qualifies for such benefits by meeting one or more categorical tests." According to article 7(15)(c), however, parties which choose to apply the SLOB may reserve the right for the provisions not to apply to CTAs that already contain provisions limiting treaty benefits only to residents that qualify by meeting one or more categorical tests.

[32] See article 7(15)(a) of the MLI, which permits parties to the MLI to reserve the right for article 7(1) not to apply to its CTAs "on the basis that it intends to adopt a combination of a detailed limitation on

Of eighty-four jurisdictions that had signed the MLI as of 18 September 2018, all adopted the preamble text in article 6(1) and the PPT in article 7(1), fifty-four (not including Canada) adopted the additional preamble text in article 6(3), and thirteen have chosen to apply the SLOB in addition to the PPT.[33] Although no signatory reserved the right for the PPT not to apply on the basis that it intends to adopt detailed LOB provisions and either rules to address conduit financing structures or a PPT through bilateral negotiations, eight jurisdictions including Canada have stated that they accept the PPT alone "as an interim measure" but "intend … where possible to adopt a limitation on benefits provision, in addition to or in replacement of [the PPT], through bilateral negotiations."[34]

2. Other Treaty Abuses

In addition to its recommendations and minimum standards to address tax treaty shopping, the Final Report of BEPS Action 6 also contains recommendations and proposed treaty provisions to address other situations where persons enter into transactions or arrangements to satisfy conditions of particular treaty provisions "in circumstances where it would be inappropriate to grant the relevant treaty

benefits provision and either rules to address conduit financing structures or a principal purpose test, thereby meeting the minimum standard for preventing treaty abuse under the OECD/G20 BEPS package." In this case, the provision continues, "the Contracting Jurisdictions shall endeavour to reach a mutually satisfactory solution which meets the minimum standard." See also article 7(17)(a), which permits a party to the MLI to declare that it accepts the PPT alone "as an interim measure" but "intends where possible to adopt a limitation on benefits provision, in addition to or in replacement of [the PPT], through bilateral negotiations."

33 Figures compiled by the author from positions of signatories available at Organisation for Economic Co-operation and Development, "Signatories and Parties to the Multilateral Convention To Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting: Status as of 18 September 2018" (http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf).

34 *Ibid.*

benefits."[35] Although observing that the PPT "will be useful in addressing such situations,"[36] the Report rightly notes that that "targeted specific treaty anti-abuse rules generally provide greater certainty for both taxpayers and tax administrations."[37] For this reason, it provides "examples of situations with respect to which specific treaty anti-abuse rules may be helpful and proposals for changes intended to address some of these situations."[38]

In order to prevent tax-motivated transactions or arrangements intended to obtain the reduced withholding tax rate on dividends paid to a parent company, for example, the Report proposes that the reduced rate should be available only where the minimum ownership threshold is satisfied "throughout a 365 day period that includes the day of the payment of the dividend.[39] Incorporated into article 10(2)(a) of the 2017 OECD model convention, this minimum shareholding period provides greater certainty than the application of limited purpose tests in many tax treaties or the application of a general anti-abuse principle.[40] In order to prevent tax-motivated transactions or arrangements intended to avoid a substituted property rule for capital gains by diluting the proportion of an entity's value attributable to immovable property in a state, the Report also proposes that the value threshold for

[35] Final Report on BEPS Action 6, *supra* note 4, para. 27.
[36] *Ibid*.
[37] *Ibid*. As a result, according to paragraph 62 of the commentary on the 2017 OECD model convention, the existence of a PPT "does not mean that there is no need for the inclusion, in tax conventions, of specific provisions aimed at preventing particular forms of tax avoidance." On the contrary, it explains: "Where specific avoidance techniques have been identified or where the use of such techniques is especially problematic, it will often be useful to add to the Convention provisions that focus directly on the relevant avoidance strategy."
[38] *Ibid*.
[39] *Ibid*. at para. 36. For the purpose of computing this period, the proposed provision explicitly excludes "changes of ownership that would result directly from a corporate reorganization, such as a merger or divisive reorganization, of the company that holds the shares or that pays the dividend."
[40] See the discussion of pre-BEPS approaches to these transactions or arrangements in the first part of this article.

the substituted property rule should apply "at any time during the 365 days preceding the alienation" of the shares or comparable interests subject to the rule.[41] As with the minimum shareholding period for dividends, the time period for this value threshold was added to the 2017 OECD model convention.[42]

In addition to these specific treaty anti-abuse rules, the Final Report of BEPS Action 6 also discusses anti-abuse provisions to prevent the tax-motivated splitting-up of contracts to avoid permanent establishment status for a building site or construction or installation project that lasts more than twelve months,[43] "hiring-out of labour" arrangements designed to convert employment income that would otherwise be subject to tax in which the employment is exercised into employment income that is exempt from source state taxation,[44] and transactions designed to convert dividends into capital gains.[45] It also proposes an alternative tie-breaker rule for dual-resident entities that replaces the place of effective management test with competent authority determination,[46] and a specific anti-abuse provision for low-taxed income attributable to a permanent establishment in a third state that is exempt from tax in the residence state.[47] article 4(3) of the 2017 OECD model convention replaces the place of effective management test for dual-resident entities with competent authority determination, and article 29(8) adds the anti-abuse rule for low-taxed income attributable to a permanent establishment in a third state.

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[41] Final Report on BEPS Action 6, *supra* note 4, paras. 43-44.
[42] Article 13(4) of the 2017 OECD model convention.
[43] Final Report on BEPS Action 6, *supra* note 4, para. 29.
[44] *Ibid*. para. 31.
[45] *Ibid*. para. 32.
[46] *Ibid*. paras 45-48.
[47] *Ibid*. paras 49-52.

As with the BEPS proposals on measures to prevent tax treaty shopping, provisions to prevent other treaty abuses were also included in the MLI, which contains anti-avoidance rules for dividends and capital gains in articles 8(1) and 9(1), an anti-avoidance rule for low-taxed income attributable to a permanent establishments in third jurisdictions in article 10(1), an anti-avoidance rule for splitting-up of contracts in article 14(1), and the alternative tie-breaker rule for dual-resident entities in article 4(1). Unlike the proposals on measures to prevent tax treaty shopping, however, none of these provisions constitute minimum standards that signatories to the MLI must adopt, and none will modify a CTA unless all parties to the CTA choose to apply the provision and notify the OECD to this effect.[48] Of the eighty-four jurisdictions that had signed the MLI as of 18 September 2018, thirty-seven opted to apply the rule for dividends in article 8(1), forty-eight opted to apply the rule for capital gains in article 9(1), twenty-three opted to apply the rule for low-taxed permanent establishments in article 10(1), twenty-eight opted to apply the rule for splitting-up of contracts in article 14(1), and twenty-nine opted to apply the alternative tie-breaker rule for dual-resident entities in article 4(1).[49] Although Canada did not choose to apply any of these provisions when it signed the MLI on 7 June 2017,[50] it has subsequently indicated that it will adopt the anti-

[48] See Articles 8(4), 9(8), 10(6), 14(4) and 4(4) of the MLI.

[49] Figures compiled by the author from positions of signatories available at OECD, "Signatories and Parties to the Multilateral Convention To Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting: Status as of 18 September 2018" *supra* note 33.

[50] Department of Foreign Affairs, Trade and Development, "Status of List of Reservations and Notifications at the Time of Signature" 30 May 2017 (www.oecd.org/tax/treaties/beps-mli-position-canada.pdf).

avoidance rules for dividends and capital gains in articles 8(1) and 9(1) and the alternative tie-breaker rule for dual-resident entities in article 4(1).[51]

B. The Principal Purpose Test

Of the many provisions of the MLI, the most important are the preamble text in article 6(1) and the PPT in article 7(1), which have been adopted by all signatories to the Convention in order to implement the minimum standard on treaty abuse. While the preamble text states that the CTA is intended to eliminate double taxation "without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),"[52] the PPT reads as follows:

> Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in those circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.[53]

Based on a "guiding principle" in the commentary on the OECD model convention,[54] and similar in structure to Canada's general anti-avoidance rule

[51] Department of Finance Canada, "Backgrounder: The Next Step in the Fight Against Aggressive International Tax Avoidance" 21 June 2018 (https://www.canada.ca/en/department-finance/news/2018/05/backgrounder-the-next-step-in-the-fight-against-aggressive-international-tax-avoidance.html).

[52] Article 6(1) of the MLI. This language also appears in the preamble to the 2017 OECD model convention.

[53] Article 7(1) of the MLI. This provision also appears as article 29(9) of the 2017 OECD model convention.

[54] See Paragraph 169 of the commentary on article 29 of the OECD model convention, referring to the "guiding principle" in para. 61 of the 2017 OECD model convention, according to which "the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that

(GAAR),[55] this provision introduces a general anti-avoidance or anti-abuse rule to CTAs. According to the commentary on the 2017 OECD model convention, the PPT is intended to "allow States to address cases of improper use of the Convention even if their domestic law does not allow then to do so" and to "confirm" the application of a general anti-abuse principle "for States whose domestic law already allows them to address such cases."[56] The remainder of this article examines this provision in detail, considering its relationship to other anti-avoidance doctrines, principles and rules, and the various elements that comprise its basic structure, in order to determine the kinds of transactions or arrangements to which it may be expected to apply and the consequences of its application.

1. Relationship to Other Anti-Avoidance Doctrines, Principles and Rules

Beginning with the relationship between the PPT and other anti-avoidance doctrine, principles and rules, three questions may be posed. First, how does the PPT interact with domestic anti-avoidance doctrines and statutory anti-avoidance rules? Second, does the PPT displace implicit general anti-abuse principles like the "guiding principle" in the commentary on the OECD model convention? And third, how should the PPT relate to specific treaty anti-abuse rules that are included (or not included) in a CTA? The following sections address each of these questions.

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more favourable treatment in the circumstances would be contrary to the object and purpose of the relevant provisions."

[55] *Income Tax Act*, R.S.C. 1985, c. I-1, s. 245 (as amended) [hereafter ITA]. Like the PPT, this provision applies to deny a tax benefit where three requirements are satisfied: (1) a transaction (or series of transactions of which the transaction is a part) would otherwise result directly or indirect in a tax benefit; (2) the transaction may not reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; and (3) it may reasonably be considered that the transaction would otherwise result in a misuse of provisions of the ITA or other relevant enactments or an abuse having regard to those provisions read as a whole.

[56] Paragraph 169 of the commentary on article 29 of the OECD model convention.

(1) Relationship to Domestic Anti-Avoidance Doctrines and Statutory Anti-Avoidance Rules

Since domestic law generally determines the characterization of transactions or arrangements to which tax treaties apply, it seems reasonable to conclude that the PPT will not displace domestic anti-avoidance doctrines and statutory anti-avoidance rules that apply to transactions or arrangements that might otherwise be subject to the PPT. Where tax-motivated emigration is subject to a domestic exit tax, for example, reliance on the PPT is likely unnecessary. Similarly, where tax avoidance transactions or arrangements are re-characterized under domestic anti-avoidance doctrines or statutory general anti-avoidance rules, the PPT is presumably redundant. For these reasons, the commentary on the 2017 OECD model convention affirms the "important role" of domestic anti-abuse rules and judicial doctrines in "preventing treaty benefits from being granted in inappropriate circumstances" irrespective of the PPT.[57]

To the extent that treaty provisions prevail over conflicting provisions of domestic law, however, it may be argued that domestic anti-avoidance doctrines and statutory anti- avoidance rules are inapplicable if they result in taxation that is not in accordance with the provisions of a tax treaty.[58] Although the commentary explains that these conflicts will be avoided in many cases[59] – for example, where the treaty specifically allows the application of specific domestic anti-abuse rules,[60] where the

[57] Paragraph 67 of the commentary on article 1 of the OECD model convention.
[58] Paragraph 70 of the commentary on article 1 of the OECD model convention.
[59] Paragraph 71 of the commentary on article 1 of the OECD model convention.
[60] Paragraph 72 of the commentary on article 1 of the OECD model convention.

treaty specifically depends on the application of domestic law,[61] or where the application of a treaty provision is denied under judicial doctrines or principles of treaty interpretation[62] – it also suggests that the PPT could apply to deny a benefit under a treaty provision that would otherwise prevail over a domestic anti-avoidance rule.[63] It also concludes that general statutory anti-avoidance rules do not conflict with tax treaties to the extent that they conform to the "guiding principle" and the PPT, since "the relevant domestic general anti-abuse rule will apply in the same circumstances in which the benefits of the Convention would be denied" under the "guiding principle" or the PPT.[64]

For these reasons, it is clear that the PPT does not preclude reliance on domestic anti-avoidance doctrines and statutory anti-avoidance rules,[65] which should presumably be applied prior to the PPT since these doctrines and provisions generally determine the characterization of transactions or arrangements to which tax treaties apply. Nor does the application of a domestic anti-avoidance doctrine or provision preclude application of the PPT where the anti-avoidance doctrine or provision is subject to a treaty provision that would otherwise prevail over the domestic doctrine or provision. As a result, it follows that transactions or

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[61] Paragraph 73 of the commentary on article 1 of the OECD model convention, referring for example, to the determination of a person's residence, the determination of immovable property, and the determination of when income from corporate rights may be treated as a dividend.

[62] Paragraph 75 of the commentary on article 1 of the OECD model convention, providing an example of a transaction characterized as a sham under domestic law. See also paragraph 78 of the commentary on article 1 of the OECD model convention, referring to judicial anti-avoidance doctrines "such as substance over form, economic substance, sham, business purpose, step-transaction, abuse of law and *fraus legis*."

[63] Paragraph 74 of the commentary on article 1 of the OECD model convention, providing as an example a domestic anti-avoidance rule taxing capital gains of former residents that might otherwise be subject to the treaty exemption in article 13(5) of the OECD model convention.

[64] Paragraph 72 of the commentary on article 1 of the OECD model convention.

[65] See, e.g., Luc De Broe and Joris Luts, "BEPS Action 6; Tax Treaty Abuse" (2015), 43:2 *Intertax* 135 at 139.

arrangements may be assessed under domestic anti-avoidance doctrines and statutory anti-avoidance rules as well as the PPT.

(2) Relationship to Implicit Anti-Abuse Principle

According to the commentary on the OECD model convention, the "guiding principle" that a benefit under a tax treaty should not be available where "one of the principal purposes of arrangements or transactions is to secure a more favourable tax position" and "obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions" of the treaty, "applies independently from the provisions of [the PPT], which merely confirm it."[66] On this basis, it follows that the concept of an implicit anti-abuse principle reflected in the "guiding principle" is not displaced by the PPT, but may operate alongside as an independent approach to address tax treaty shopping and other treaty abuses.

Notwithstanding this statement, however, a strong argument can be made as a matter of treaty interpretation that an explicit anti-abuse provision like the PPT should prevail over an implicit anti-abuse principle like the "guiding principle".[67] Indeed, subsequent statements in the commentary suggest that the "guiding principle" is best understood as an alternative to the PPT, which "applies independently" of the PPT only in the interpretation of tax treaties that do not include a PPT.[68] For this reason, as Danon concludes, the "status and function of the

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[66] Paragraph 61 of the commentary on article 1 of the OECD model convention.

[67] See, e.g., De Broe and Luts, *supra* note 65 at 140-141.

[68] See, e.g., paragraphs 74 and 77 of the commentary on article 1 of the OECD model convention, arguing that domestic anti-abuse rules generally do not conflict with tax treaties since benefits otherwise available under a treaty may be denied under the PPT, "or, <u>in the case of a treaty that does not include that paragraph</u>" under the "guiding principle" [emphasis added].

guiding principle will obviously be less important" following the introduction of the PPT into the text of the 2017 OECD model convention and the MLI.[69]

(3) Relationship to Specific Treaty Anti-Abuse Rules

More challenging, and likely more important, than the relationship between the PPT and domestic anti-avoidance doctrines and statutory anti-avoidance rules or the relationship between the PPT and the "guiding principle" is the relationship between the PPT and specific treaty anti-abuse rules that may be included (or not included) in a CTA. As the parenthetical words in the previous sentence suggest, this issue involves two separate inquiries, concerning the relationship between the PPT and specific treaty anti-abuse rules that are included in a particular CTA, and the relationship between the PPT and specific treaty anti-abuse rules contained in the MLI or other tax conventions, including model tax conventions, but not adopted in that CTA.

(a) Relationship to Specific Treaty Anti-Abuse Rules in a CTA

Where a CTA includes a specific anti-abuse rule or SAAR, the relationship between the PPT and this rule can become an issue in two kinds of cases: where the SAAR applies to a particular transaction or arrangement, or where a transaction or arrangement is not subject to a SAAR because it satisfies the formal requirements of the rule.

In the first case, where the SAAR applies to a transaction or arrangement, the interpretive principle that a specific provision prevails over a more general

[69] Robert J. Danon, "Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups" (January 2018), 72 *Bulletin for International Taxation* 31 at 38.

provision (*lex specialis derogat legi generali*) suggests that the PPT should have no application. In the domestic context, for example, courts typically regard GAARs as provisions "of last resort" that apply only to deny tax benefits that are not otherwise denied under anti-avoidance doctrines or specific anti-avoidance rules,[70] concluding on this basis that a GAAR cannot be applied to impose additional tax consequences beyond those resulting from a specific anti-avoidance rule.[71] For this reason, some commentators have argued that the PPT should generally not apply to abusive transactions or arrangements that "could be tackled" under both the PPT and a treaty-based SAAR.[72]

Since the PPT explicitly applies "[n]otwithstanding any provisions of a Covered Tax Agreement," however, it follows that the words of this provision override the *lex specialis* principle that would otherwise apply.[73] As a result, the proper interpretive question is not simply whether a treaty-based SAAR prevails over the PPT, but whether a transaction or arrangement that is subject to a SAAR may still result in a "benefit under a CTA" to which the PPT could apply. Indeed, the commentary to the 2017 OECD model convention supports this interpretation, stating that a benefit that is denied under an LOB provision or a SAAR for low-taxed permanent establishments in third jurisdictions "is not a 'benefit under the Convention' that [the PPT] would also deny."[74] If application of a SAAR were to result

[70] *Canada Trustco Mortgage Co. v Canada*, 2005 SCC 56, [2005] 2 SCR 601, [2005] 5 C.T.C. 215, 2005 D.T.C. 5523, at para. 21 [hereafter *Canada Trustco*].
[71] *XCo Investments Ltd. v. Canada*, [2006] 1 C.T.C. 2220, 2005 D.T.C. 1731 (T.C.C.), aff'd [2007] 2 C.T.C. 243, 2007 D.T.C. 5146 (F.C.A.), at para. 40, stating that the GAAR cannot be used to "top up" a remedy under a specific anti-avoidance rule.
[72] See, e.g., Danon, *supra* note 69 at 52.
[73] See, e.g., De Broe and Luts, *supra* note 65 at 146.
[74] Paragraph 171 of the commentary on article 29 of the OECD model convention.

in a treaty benefit, however, judicial decisions in context of domestic GAARs suggest that a general anti-abuse rule could be applied to deny this benefit if it would contradict the object and purpose of the SAAR.[75] In practice, however, it is difficult to imagine a case in which a SAAR could be used to produce a benefit under a CTA.

In the second case, where a transaction or arrangement is not subject to a treaty-based SAAR because it satisfies the formal requirements of the rule, different considerations apply. Although the *lex specialis* principle might suggest that the PPT should not apply in this circumstance, this conclusion depends on whether the SAAR fully addresses the particular transaction or arrangement at issue.[76] For example, since the beneficial owner requirement addresses only “some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else),” the commentary on the OECD model convention is clear that the PPT can apply to transactions or arrangements even if they satisfy this requirement.[77] Likewise, since LOB provisions do not address all forms of tax treaty shopping, it is clear that the PPT can apply to transactions or arrangements such as conduit financing arrangements that satisfy one or more LOB provisions.[78]

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[75] See, e.g., *Lipson v. Canada*, [2009] 1 C.T.C. 314, 2009 D.T.C. 5015 (S.C.C.) [hereafter *Lipson*] at para. 42, in which a majority of the Supreme Court of Canada applied the GAAR to a series of transactions that were subject to a specific attribution rule on the basis that “a specific anti-avoidance rule” had been “used to facilitate abusive tax avoidance.”

[76] See, e.g., Danon, *supra* note 69 at 53, arguing that application of the PPT in this circumstance depends on whether the specific anti-abuse rule “covers the factual situation at issue.”

[77] Paragraph 12.5 of the commentary on article 10 of the OECD model convention, stating that the fact that the recipient of a dividend is its beneficial owner “does not mean … that the limitation of tax” under article 10(2) “must automatically be granted” and that the PPT and general anti-abuse principles “will apply to prevent abuses, including treaty-shopping situations where the recipient is the beneficial owner of the dividends.” Virtually identical language appears in paragraph 10.3 of the commentary on article 11 and paragraph 4.4 of the commentary on article 12.

[78] This is clear from the Final Report on BEPS Action 6, *supra* note 4 at para. 19, recommending both a specific anti-abuse rule based on LOB provisions and a PPT “to address other forms of treaty abuse, including treaty shopping situations that would not be covered by the LOB rule” [emphasis added].

For the same reason, the PPT could also apply to transactions or arrangements that satisfy the formal requirements of other treaty provisions or circumvent the application of other SAARs. Although these provisions often include quantitative limitations that arguably create safe harbours for transactions or arrangements that either satisfy or avoid these limitations,[79] any conclusion that the *lex specialibus* principle excludes the PPT in these circumstances also depends on whether these provisions fully address the transactions or arrangements at issue. Where a treaty provision that reduces the withholding tax rate on dividends paid to a parent company with a minimum shareholding does not include a minimum withholding period, for example, it is not clear that the *lex specialibus* principle prevents the PPT from applying to a transaction in which a company with a shareholding less than the minimum increases its shareholding shortly before the payment of a dividend in order to obtain the reduced withholding tax rate.[80] Likewise, where a substituted property rule for capital gains on the alienation of shares or comparable interests deriving their value principally from immovable property does not include a time period preceding the alienation during which this value threshold may apply, it is arguable that the *lex specialibus* principle does not

See also paragraph 172 of the commentary on article 29 of the OECD model convention, stating that "the fact that a person is entitled to benefits" under a specific LOB provision "does not mean that these benefits cannot be denied" under the PPT, and the example in paragraph 173 of the commentary of a publicly-traded bank that enters into conduit financing arrangement, which the commentary concludes would be subject to the PPT even though it would be entitled to benefits under a LOB provision as a "qualified person".

[79] See, e.g., Danon, *supra* note 69 at 53, arguing that "it would be unacceptable to first include a SAAR in a tax treaty that specifically circumscribes the taxpayer behaviour which the treaty partners consider abusive on the basis of objectively verifiable (often quantitative, safe harbor) parameters, only to subsequently apply the PPT rule to extend the legal consequences provided therein to other situations beyond the scope of that SAAR."

[80] Before 2017, paragraph 17 of the commentary on article 10 of the OECD model convention characterized this kind of transaction as an "abuse" of the provision to which the reduced withholding tax rate "should not be available".

prevent the PPT from applying to a transaction carried out shortly before alienation of shares or other interests that dilutes the proportion of an entity's value attributable to immovable property in order to circumvent the rule.

Moreover, since the text of the PPT explicitly states that it applies "[n]otwithstanding any provisions of a Covered Tax Agreement," it appears as thought the PPT could apply to a transaction or arrangement one of the principal purposes of which is to obtain a benefit under a CTA even if the transaction or arrangement satisfies or circumvents the formal requirements of other treaty provisions including SAARs. In this circumstance, however, the relevant interpretive question is not whether a transaction or arrangement results in a benefit under a CTA (since this will be the case where the transaction or arrangement satisfies or circumvents the formal requirements of the relevant treaty provisions), but whether granting the benefit in this circumstance contradicts the object and purpose of these provisions.[81] While the satisfaction or avoidance of a quantitative limitation in a specific treaty provision creates a strong presumption that granting the resulting benefit is consistent with the object and purpose of the relevant provisions,[82] this determination is ultimately a matter of interpretation having regard to the relevant provisions as well as extrinsic materials such as explanatory memoranda and commentaries that may shed light on the intentions of the contracting jurisdictions. Since a key objective of specific treaty anti-abuse rules is "to provide greater

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[81] This aspect of the PPT is examined in further detail below at *infra* notes 198-273 and accompanying text.

[82] See, e.g., Michael Lang, "BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties" (19 May 2014) *Tax Notes International* 655 at 658, observing that "it is hard to understand why [the PPT] should in some cases reduce the percentage" threshold of a substituted property rule that applies to shares or comparable interests the value of which is principally attributable to immovable property in a state "to 50 percent or less."

certainty for both taxpayers and tax administrations,"[83] however, it seems reasonable to conclude that benefits resulting from transactions or arrangements that comply with quantitative limitations in these provisions are generally consistent with their object and purpose.

(b) Relevance of Specific Treaty Anti-Abuse Rules not Included in a CTA

Where a particular CTA is not modified by a SAAR that is contained in the MLI or does not otherwise include a SAAR that is contained in the MLI or another tax convention, including a model tax convention, a different question arises as to whether the PPT can apply to transactions or arrangements that would otherwise be subject to this SAAR. Although it might reasonably be argued that the absence of this rule in the contest of a particular CTA evidences an intention on the part of the contracting jurisdictions to grant treaty benefits resulting from transactions or arrangements that would otherwise be subject to the rule,[84] it may also be argued that the contracting jurisdictions intend to rely on the PPT to challenge these transactions or arrangements without adopting the detailed limitations of the SAAR.[85] As with the relationship between the PPT and SAARs that either modify or are included in a particular CTA, this question is ultimately a matter of interpretation having regard to the relevant provisions as well as extrinsic materials such as

[83] Final Report on BEPS Action 6, *supra* note 4 at para. 27.

[84] For a useful example, see *Knights of Columbus v. The Queen,* [2009] 1 C.T.C. 2163, 2008 D.T.C. 3648 (T.C.C.) [hereafter *Knights of Columbus*] in which the Tax Court of Canada considered the absence of a specific insurance provision like article 5(6) of the United Nations model tax convention in the Canada-U.S. Treaty to be a relevant consideration in concluding that the taxpayer had not carried on business in Canada through a permanent establishment. See United Nations, *Model Double Taxation Convention between Developed and Developing Countries*, (New York: United Nations, 2011), article 5(6) [herein referred to as the United Nations model tax convention]

[85] See, e.g., Danon, *supra* note 69 at 43, concluding that "[w]here a state has reserved the right not to apply" the specific anti-abuse rules in articles 8(1) and 9(1) of the MLI, "the PPT would thus apply by default to those situations."

explanatory memoranda and commentaries that may shed light on the intentions of the contracting jurisdictions.

Beginning with LOB provisions, the fact that the minimum standards on treaty abuse may be satisfied by a PPT alone or by a combination of PPT and LOB provisions, suggests that the PPT could apply to benefits that might otherwise be denied under specific LOB provisions that do not modify and are not otherwise included in a particular CTA.[86] This conclusion is also supported by the fact that the minimum standards require signatories to the MLI to adopt the amended preamble language declaring that the CTA is not intended to create "opportunities for non-taxation or reduced taxation through tax avoidance or evasion … including through treaty shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions."[87] As a result, although the commentary on the OECD model convention does not specifically address this issue, the amended preamble text and the context of BEPS Action 6 strongly suggest that the PPT may apply to tax treaty-shopping transactions or arrangements that would be subject to an LOB provision if it modified or were otherwise included in a CTA.

Likewise with "dividend transfer transactions" that are specifically addressed by the minimum shareholding period for the reduced withholding tax rate on dividends in article 8(1) of the MLI, the text of the MLI and the context of this SAAR suggest that the PPT could apply to transactions or arrangements that would be

[86] As explained at *supra* text accompanying notes 33-34, only thirteen signatories to the MLI have chosen to apply the SLOB as well as the PPT, and only eight have indicated that they intend to adopt LOB provisions in addition to or in replacement of the PPT through bilateral negotiations. As a result, most CTAs subject to the MLI will not include LOB provisions.
[87] Article 6(1) of the MLI.

subject to this rule if it modified or were otherwise included in a particular CTA. Since the MLI provides that the PPT applies "in place of" limited purpose tests in CTAs, [88] which could be used to challenge rule-shopping transactions or arrangements undertaken to obtain a reduced withholding tax rate on dividends paid by a subsidiary to a parent company,[89] it is difficult to see why the replacement of these provisions by the PPT should preclude the application of this more general anti-abuse provision to these transactions or arrangements in the absence of a minimum shareholding period for the reduced withholding tax rate on dividends. As well, since the pre-2017 commentary on the OECD model convention characterized dividend transfer transactions as an "abuse" of article 10(2)(a) to which the reduced withholding tax rate "should not be available",[90] and the PPT was introduced to "confirm" the application of a general anti-abuse principle to tax treaties,[91] it would be odd to conclude that the PPT should not apply to these transactions or arrangements because they might also be addressed by a SAAR that does not apply to or is not otherwise included in a particular CTA. Indeed, although the commentary on the OECD model convention does not explicitly state that the PPT can apply to deny benefits that would otherwise be denied under article 8(1) of the MLI, this conclusion is suggested by an example that considers the possible application of the PPT to a transaction that could be subject to this specific anti-abuse rule.[92] As a

[88] Article 7(2) of the MLI.
[89] See the discussion of "Other Treaty Abuses" in the first part of this article.
[90] Paragraph 17 of the commentary on article 10 of the 2003 OECD model convention.
[91] Paragraph 61 of the commentary on article 1 of the OECD model convention, and paragraph 169 of the commentary on article 29 of the OECD model convention.
[92] Example E in paragraph 182 of the commentary on article 29 of the OECD model convention, which is discussed at *infra*, text accompanying notes 262-265. See also paragraph 16 of the commentary on article 10 of the OECD model convention, which notes the addition of a minimum shareholding period

result, although at least one commentator has argued that the PPT should not apply to deny a treaty benefit resulting from a dividend transfer transaction if the dividend article does not include a minimum shareholding period,[93] it seems more reasonable to conclude that the PPT could apply in this circumstance, absent some indication that the contracting jurisdictions intended that the PPT should not apply in such circumstances to CTAs without a minimum shareholding period.

A similar argument supports the conclusion that the PPT could apply to contract-splitting transactions or arrangements in order to avoid permanent establishment status for a building site or construction or installation project lasting more than twelve months, even if the CTA does is not modified by or not otherwise include a SAAR like article 14(1) of the MLI that aggregates the time periods of separate contracts involving connected activities carried on by closely related enterprises.[94] These transactions or arrangements were considered abusive in the pre-2017 commentary on the OECD model convention,[95] and are also addressed in the 2017 commentary, which suggests that "these abuses could … be addressed" through the PPT.[96] As a result, as one commentator observes, "having reserved not

to article 10(2)(a) of the OECD model convention, but concludes that the PPT could apply to "other abusive arrangements aimed at obtaining the benefits" of the reduced withholding tax rate under this provision.

93 Reinout Kok, "The principal purpose test in tax treaties under BEPS 6" (2016), 44:5 *Intertax* 406 at 411.

94 See the discussion of this provision at *supra* text accompanying notes 43 and 48-49 under the heading "Other Treaty Abuses".

95 Paragraph 18 of the commentary on article 5 of the 2003 OECD model convention.

96 Paragraph 52 of the commentary on article 5 of the OECD model convention. See also example J in paragraph 182 of the commentary on article 29 of the OECD model convention.

to apply this specific SAAR to their CTAs, countries may … tackle this fact pattern on the basis of the PPT rule."[97]

Indeed, since the commentary on abusive contract-splitting also states that "[s]ome States may nevertheless wish to deal expressly with such abuses"[98] it appears as though specific anti-abuse rules in the MLI could, like LOB provisions, be regarded as complements to the PPT, which do not preclude application of the PPT to transactions or arrangements that would be addressed by these specific anti-abuse rules if they were included in a CTA. On this basis, the PPT could also apply to transactions or arrangements that dilute the proportion of an entity's value attributable to immovable property in order to avoid a substituted property rule or "hiring-out of labour" arrangements in order to avoid source taxation of employment income, even if the CTA does not include a specific anti-abuse provision that would otherwise address these transactions or arrangements. Although the commentary is silent on the possible application of the PPT to transactions or arrangements that avoid a substituted property rule that does not include a time period test like the one in article 9(1) of the MLI,[99] it explicitly affirms the application of the PPT to hiring-out of labour arrangements even if a treaty does not include a specific anti-abuse rule to address these arrangements.[100]

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[97] Danon, *supra* note 69 at 44.
[98] Paragraph 52 of the commentary on article 5 of the OECD model convention.
[99] See the discussion of this provision at *supra* text accompanying notes 41-42 and 48-49 under the heading "Other Treaty Abuses".
[100] Paragraph 8.8 of the commentary on article 15 of the OECD model Convention, stating that a state "may deny the application of the exception" in article 15(2) of the OECD model convention "in abusive cases" – "as recognized by" the PPT.

2. Basic Structure of the PPT

Like the guiding principle and the Canadian GAAR, the application of the PPT turns on three tests. According to the first of these tests, which may be called the "result test", a transaction or arrangement must have "resulted directly or indirectly" in a benefit under a CTA. According to the second test, which is a "purpose test", it must be "reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes" of the transaction or arrangement. Finally, the third test is an "object and purpose test" which provides that the PPT does not apply if it is established that granting the benefit in the circumstances would be "in accordance with the object and purpose of the relevant provisions" of the CTA. Where the first two tests are satisfied and the third is not, the effect of the PPT is to deny the benefit that would otherwise be granted in respect of an item of income or capital under the CTA. The following sections consider each of these tests, as well as the consequences of its application, considering similarities to and differences from the guiding principle and the Canadian GAAR.

(1) Result Test

Although the PPT is based on the guiding principle, which refers to "the benefits of a double tax convention", the language and structure of the result test in the PPT is actually much closer to the Canadian GAAR, which denies a "tax benefit" that would otherwise "result, directly or indirectly" from an avoidance transaction or a series of transactions that includes an avoidance transaction. In order to fully understand this test, it is necessary to consider each of its elements: (1) the meaning of a “benefit under a Covered Tax Agreement”, (2) the meaning of an “arrangement or transaction”, and (3) the requirement that the arrangement or transaction has “resulted directly or indirectly” in the benefit.

(a) Benefit under a CTA

It is curious that neither the MLI nor the 2017 OECD model convention define the term “benefit under a Covered Tax Agreement”. In contrast, the concept of a “tax benefit” for the purposes of the Canadian GAAR is explicitly defined as:

> a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty.[101]

Since article 1(2) of the MLI states that an undefined term shall, unless the context otherwise requires, have the meaning that it has at that time under the relevant CTA, and tax treaties generally provide that terms that are not defined in the treaty shall, unless the context otherwise requires, have the meaning that they have under domestic law at the time, it might be argued that a domestic definition such as this one should apply for the purposes of the PPT. Because the PPT refers to a benefit “under a Covered Tax Agreement”, however, it seems clear that the concept has an autonomous international fiscal meaning and should not be defined according to the meaning of a tax benefit for the purposes of domestic law. This interpretation also supports one of the purposes of the PPT, to foster greater uniformity among contracting jurisdictions in their responses to tax treaty abuse.

Consistent with this interpretation, the commentary to the 2017 OECD model convention states that the concept of a “benefit under a Covered Tax Agreement”

[101] ITA, s. 245(1).

contemplates treaty limitations on source taxation under the distributive rules of a CTA, as well as treaty benefits attributable to an elimination of double taxation article, including benefits from a tax sparing provision.[102] It also states that a benefit under a CTA could also include protection against non-discrimination under provisions comparable to article 24 of the OECD model convention, though it is difficult to imagine how this benefit could be obtained abusively.[103] In contrast, the commentary does not identify other benefits under a CTA, such as the availability of dispute resolution mechanisms under the mutual agreement procedure or arbitration, though at least one commentator has suggested that these mechanisms are not themselves "benefits" but processes through which benefits may be obtained.[104] Nor does the commentary address unilateral benefits under domestic law such as foreign tax credits or participation exemptions, though it seems reasonable to conclude that these benefits are not benefits "under a Covered Tax Agreement" to which the PPT could apply, even if these benefits are contemplated by an elimination of double taxation article in a CTA.[105]

Although the commentary on the OECD model convention provides useful guidance on the general concept of a "benefit under a Covered Tax Agreement", the characterization of a benefit in the context of a specific transaction or arrangement necessarily depends on a standard or benchmark against which the existence of a "benefit" is measured. Since the PPT refers to a benefit "under a Covered Tax Agreement", an obvious interpretation of this benchmark would be the tax

[102] Paragraph 175 of the commentary on article 29 of the OECD model convention.
[103] See, e.g., Lang, *supra* note 82 at 657; and De Broe and Luts, *supra* note 65 at 144.
[104] Lang, *supra* note 82 at 657.
[105] See, e.g., De Broe and Luts, *supra* note 65 at 144; and Danon, *supra* note 69 at 43.

consequences that would have resulted under the domestic law of a contracting jurisdiction absent the CTA.[106] Alternatively, as with the characterization of a tax benefit for the purposes of the Canadian GAAR, the existence of a "benefit" under a CTA could be determined by comparing the tax consequences resulting from the specific transaction or arrangement at issue with the tax consequences that would have resulted from an alternative transaction or arrangement that that "might reasonably have been carried out but for the existence of the … benefit."[107]

Because the PPT stipulates that "a benefit under a Covered Tax Agreement shall not be granted" whenever the provision applies, the first interpretation could have punitive consequences, since the PPT would deny the treaty benefit that would otherwise result from the specific transaction or arrangement at issue without recognizing benefits that would have resulted under the same CTA or another tax treaty from an alternative transaction or arrangement that would otherwise have been carried out.[108] For this reason, absent any indication that the PPT is intended to have this punitive effect, it might be argued that the second interpretation should be preferred.

Textually, however, the meaning of "a benefit under a Covered Tax Agreement" seems more compatible with the first interpretation than the second, which instead contemplates an overall benefit "from" the CTA, not a specific benefit

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[106] See, e.g., Lang, *supra* note 82 at 657, stating that: "Obviously, what is meant is that the tax situation would have to improve for the taxpayer as a result of the application of one or several treaty provisions *as compared with the domestic legislation* …." [emphasis added]
[107] *Copthorne Holdings v. Canada*, 2011 SCC 63, [2011] 3 SCR 721, [2012] 2 C.T.C. 29, 2012 D.T.C. 5007 [*Copthorne Holdings*] at para. 35, citing D.G. Duff, et. al, *Canadian Income Tax Law*, 3d ed. (Markham: LexisNexis, 2009) at 187.
[108] See the discussion at *infra* text accompanying notes 274-286 under the heading "Consequences of Application". As noted below, these punitive consequences may be relieved under a remedial benefits provision in article 7(4) of the MLI.

"under" the CTA. More significantly, perhaps, the MLI also contains a remedial benefits rule authorizing the competent authority of the contracting jurisdiction that would otherwise have granted a benefit under a CTA to:

> … nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement.[109]

Taking this provision into account, therefore, it seems more reasonable to conclude that the existence of a benefit under a CTA should be determined by reference to the tax consequences that would have resulted under the domestic law of a contracting jurisdiction absent the CTA, not the tax consequence that would have resulted from an alternative transaction or arrangement that would otherwise have been carried out.[110]

On this basis, it also follows that the characterization of a benefit under a CTA should be made without regard to tax consequences in the other contracting jurisdiction, such as higher taxes in a residence state on account of reduced foreign tax credits to offset lower taxes in a source state, even if these tax consequences are governed by the CTA rather than domestic law. While these offsetting tax consequences may affect a taxpayer's overall tax burden in both contracting

[109] Article 7(4) of the MLI. This provision is discussed later in this article under the heading "Consequences of Application". Although this remedial benefits rule was not added to the 2017 OECD model convention, it appears in paragraph 184 of the commentary on the OECD model convention as an optional provision that "States are free to include … in their bilateral treaties".
[110] For a similar conclusion addressing the consequences of the PPT's application rather than the concept of a benefit under a CTA, see André Báez Moreno, "GAARS and Treaties: From the Guiding Principle to the Principal Purpose Test: What Have We Gained from BEPS Action 6?" (2017), 45 *Intertax* 432 at 442.

jurisdictions,[111] they do not affect the character of "a" benefit under a CTA, which exists whenever the CTA reduces the domestic tax of a contracting jurisdiction regardless of the impact that this tax reduction may have on taxation in the other contracting jurisdiction.[112] Although this means that the PPT could apply even if reduced taxes in one contracting jurisdiction were fully offset by increased taxes in the other contracting jurisdiction,[113] this result is presumably consistent with the object and purpose of the PPT, which is not only to prevent non-taxation or reduced taxation from the abuse of tax treaties, but also to ensure that tax treaties apply "in accordance with the purpose for which they were entered into"[114] – namely, to allocate taxing rights among contracting states in a fair and reasonable manner in order to encourage cross-border economic activity by reducing or eliminating economic double taxation.[115] Where the denial of a treaty benefit in a source state increases the tax that is paid to that state, the other state will generally be obliged to eliminate double taxation by crediting this increased tax.[116]

(b) Transaction or Arrangement

Like the concept of a benefit under a CTA, the concepts of a "transaction" or an "arrangement" are also not defined in the MLI or the OECD model convention. In

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[111] See e.g., Lang, *supra* note 82 at 657, observing that it is difficult to identify a "benefit" where a lower withholding tax burden in a source state is fully offset by higher taxation in the residence state on account of a lower foreign tax credit.

[112] For a similar conclusion, see Danon, *supra* note 69 at 43, concluding that the concept of a benefit under a CTA "exclusively covers the reduction of the domestic taxation that the state applying the tax treaty must accept".

[113] In this circumstance, on the other hand, it might be difficult to conclude that one of the principal purposes of the transaction or arrangement was to obtain a benefit under the CTA.

[114] Paragraph 174 of the commentary on article 29 of the OECD model convention.

[115] See, e.g., Luc De Broe, *International Tax Planning and the Prevention of Abuse*, (Amsterdam: IBFD, 2008) at 344. See the discussion of the object and purpose of tax treaties at *infra*, text accompanying notes 220-225.

[116] This and other consequences of the PPT's application are examined at *infra*, text accompanying notes 274-286 under the heading "Consequences of Application".

contrast, the Canadian GAAR defines a "transaction" to include "an arrangement or event", and distinguishes a transaction from a "series of transactions" which is defined to include "related transactions completed in contemplation of the series."[117] In the context of this definition, the Supreme Court of Canada has held that an ordinary series of transactions contemplates "a number of transactions that are 'pre-ordained in order to produce a given result' with 'no practical likelihood that the pre-planned events would not take place in the order ordained'',[118] and that the statutory definition of the term extends this ordinary meaning to also include transactions that are completed before or after an ordinary series "because of" or "in relation to" the ordinary series and with knowledge of the ordinary series.[119]

As with the concept of a benefit under a CTA, since the MLI does not define the meaning of a transaction or an arrangement, it is arguable that article 1(2) of the MLI requires these terms to be given the meanings that they have under the relevant CTA, in the absence of which these terms should be given the meanings that they have under domestic law. Since the Canadian GAAR defines a "transaction" to include an "arrangement" and distinguishes a "transaction" from a "series of transactions", this interpretation means that the PPT would, in the Canadian context, apply only to benefits that result from a single transaction and not from a series of transactions.

While the resolution of this interpretive issue is not as clear as it is for the concept of a "benefit under a Covered Tax Agreement", the text and context of the

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[117] ITA, s. 248(10).

[118] *Canada Trustco*, *supra* note 70 at para. 25, citing *Craven v. White*, [1989] A.C. 398 (H.L.) at 514, *per* Lord Oliver.

[119] *Ibid*. at para. 26. Although the conclusion that the extended meaning of a series of transactions can include a subsequent related transaction has been criticized as a strained interpretation of the words "in contemplation of", the Supreme Court of Canada reaffirmed this interpretation in *Copthorne Holdings*, *supra* note 107 at paras. 50-58.

PPT suggest that the terms "transaction" or "arrangement" should also be given an autonomous international fiscal meaning independent of domestic law. Although the Canadian GAAR defines a "transaction" to include an "arrangement", the ordinary meaning of an "arrangement" is broad enough to contemplate a series of transactions. More importantly, while the official French version of the ITA translates "transaction" as "opération" which is defined to include "une convention, un méchanism ou un événement", the official French version of the MLI refers to "une transaction" and "un montage" – the latter of which is also broad and clearly contemplates a series of transactions. As well, since contracting jurisdictions presumably intended the PPT to have a common meaning in all CTAs, it seems reasonable that the words "transaction" or "arrangement" should be given a meaning independent of domestic law.[120]

Not surprisingly, this interpretation is consistent with the commentary on the 2017 OECD model convention, which states that the terms transaction or arrangement "should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not legally enforceable."[121] More specifically, the commentary continues, the words "transaction" or "arrangement" include "the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues" and "encompass arrangements concerning the establishment,

120 For a similar argument that undefined words in the PPT should have an autonomous interpretation, see Błażej Kuźniacki, "The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI: Exploring the Challenges arising from Its Legal Implementation and Practical Application" (2018), 10 *World Tax J.* 1 at 6-7.

121 Paragraph 177 of the commentary on article 29 of the OECD Model Convention.

acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence."[122] As a result, as one commentator observes, the PPT could apply to abusive conduit arrangements as well as abusive restructurings.[123] Indeed, examples in the commentary on the 2017 OECD model convention suggest that the PPT could – where other requirements of the PPT are satisfied – apply to conduit arrangements such as those in *Prévost Car Inc. v. The Queen*[124] and *Velcro Canada Inc. v. Canada*,[125] dividend transfer transactions like those in the *Royal Dutch Oil Company* case[126] and the *Bank of Scotland* case,[127] as well as steps that are taken in order to change a corporation's residence for tax purposes as occurred in *MIL Investments (SA) v. The Queen*[128] and *Yanko-Weiss Holdings (1996) Ltd. v. Holon Assessing Office*.[129]

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[122] *Ibid*.
[123] Danon, *supra* note 69 at 43.
[124] [2008] 5 C.T.C. 2306, 2008 D.T.C. 3080 (T.C.C.), aff'd [2009] 3 C.T.C. 160, 2009 D.T.C. 5053 (F.C.A.) [hereafter *Prévost Car*]. This case is summarized in the first part of this article.
[125] [2012] 4 C.T.C. 2029, 2012 D.T.C. 1100 (T.C.C.) [hereafter *Velcro*]. This case is summarized in the first part of this article.
[126] BNB 1994/217[herein referred to as the *Royal Dutch Oil Company* case]. This case is discussed in the first part of this article, and is the basis for example A in paragraph 182 of the commentary on article 29 of the OECD model convention.
[127] Conseil d'Etat, Case 283314 (29 December 2006) [herein referred to as the *Bank of Scotland* case]. This case is discussed in the first part of this article, and is the basis for example B in paragraph 182 of the commentary on article 29 of the OECD model convention.
[128] [2006] 5 C.T.C. 2552, 2006 D.T.C. 3301 (T.C.C.), aff'd [2007] 4 C.T.C. 235, 2007 D.T.C. 5437 (F.C.A.) [hereafter *MIL Investments*]. This case is discussed in the first part of this article. See paragraph 180 of the commentary on article 29 of the OECD model convention, referring to a change of residence shortly before the sale of property.
[129] (2007) 10 ITLR 254 [hereafter [hereafter *Yanko-Weiss Holdings*]. This case is discussed in the first part of this article. See paragraph 177 of the Commentary on article 29 of the OECD model convention, referring specifically to "steps [that] are taken to ensure that meetings of the board of directors of a company are held in a different country in order to claim that the company has changed its residence."

(c) Benefit Results Directly or Indirectly from the Transaction or Arrangement

In order for a transaction or arrangement to "result" in a benefit under a CTA there must be a connection or nexus between the transaction or arrangement and the benefit under the CTA, such that the benefit may reasonably be considered to be attributable to the transaction or arrangement. Although this nexus may be easily established where a single transaction results directly in a benefit, it can be more difficult to identify where the benefit results indirectly from another transaction or arrangement, or where the benefit results from several transactions that may or may not comprise an arrangement or series of transactions.

Beginning with indirect benefits, the use of the words "directly or indirectly" in the PPT are intended to expand the nexus requirement, making it clear that the provision applies not only to a benefit under a CTA that results directly from transactions or arrangements one of the principal purposes of which is to obtain the benefit, but also to benefits that result from other transactions or arrangements that do not themselves result in a benefit under a CTA.[130] As a result, the commentary explains, where a company that has loaned funds to a taxpayer in a state with which the company's state of residence does not have a tax treaty transfers the loan to a subsidiary that is resident in a state with which the borrower's state of residence has entered into a tax treaty in order to obtain benefits under this treaty, the PPT could apply to deny the benefit of a reduced withholding tax rate on interest payments on

[130] See paragraph 176 of the commentary on article 29 of the OECD model convention, stating that the phrase "that resulted directly or indirectly in that benefit" is "deliberately broad" and "intended to include situations where the person who claims the application of benefits under a tax treaty may do so with respect to a transaction that is not the one that was undertaken for one of the principal purposes of obtaining that treaty benefit."

the grounds that this benefit has resulted indirectly from a tax-motivated transfer of the loan, notwithstanding that the interest payment is not itself tax-motivated.[131]

It is more difficult to determine when a number of transactions may be regarded as a series of transactions or "arrangement" for the purposes of the PPT. Although a narrow interpretation of a "series of transactions" might suggest that an "arrangement" comprises only transactions that are "pre-ordained in order to produce a given result" with "no practical likelihood that the pre-planned events would not take place in the order ordained,"[132] a broader interpretation could encompass all mutually interdependent transactions the legal effect of which would be meaningless without the series, or all transactions which are undertaken in order to obtain the particular benefit.[133] Since the PPT uses the word "arrangement" rather than the term "series of transactions" and domestic law in Canada deliberately extends the narrow meaning of a series of transactions to include related transactions completed in contemplation of a series, it seems reasonable to conclude that the meaning of an "arrangement" in the PPT should be interpreted more broadly than the narrow meaning of an ordinary series of transactions adopted in English and Canadian law.

Even if the concept of an "arrangement" is broadly defined, however, there is a limit to the transactions and events that may reasonably be included in this concept. While it may be relatively easy to conclude that an acquisition of shares by a

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[131] Paragraph 176 of the commentary on article 29 of the OECD model convention.

[132] *Canada Trustco*, *supra* note 70 at para. 25, citing *Craven v. White*, *supra* note 118.

[133] For a useful discussion of these alternative interpretations of a "series of transactions", see John Tiley, "Series of Transactions" in *1988 Conference Report: Report of Proceedings of the Fortieth Tax Conference*, (Toronto: Canadian Tax Foundation, 1988) 8:1 at 8.3-8.4.

company shortly before the payment of a dividend by another company is part of an arrangement the result of which is to obtain the benefit of a reduced withholding tax rate on the dividend payment, this conclusion is difficult to sustain where the acquisition occurs long before the payment of the dividend – particularly if the acquisition is motivated by a non-tax purpose. Likewise, where assets are contributed to a company shortly before a sale of its shares in order to dilute the proportion of the company's assets attributable to immovable property, it is relatively easy to conclude that this transaction is part of an arrangement the result of which is to obtain the benefit of a treaty exemption on capital gains from the alienation of the shares. Where the assets are contributed long before the share sale, on the other hand, it is difficult to regard this transaction as part of an arrangement the result of which is obtain a treaty benefit – especially if the assets are contributed to the company for a non-tax purpose.

In the absence of specific rules like the time period tests in articles 8(1) and 9(1) of the MLI,[134] determining whether a transaction is part of an arrangement that results in a benefit under a CTA is ultimately a matter of interpretation, having regard to the relationship between the specific transaction and other transactions and the purposes for which the transaction is undertaken. In this respect, therefore, as with the characterization of a benefit under a CTA, the determination of whether a transaction is part of an arrangement that results directly or indirectly in a benefit under a CTA necessarily depends on the purposes of the transaction.

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[134] See the earlier discussion of these provisions at *supra* text accompanying notes 39-42 and 48-49 under the heading "Other Treaty Abuses".

(2) Purpose Test

Like the guiding principle, which refers to "a main purpose" for entering into a transaction or arrangement,[135] and limited purpose tests in tax treaties which refer to "the main purpose or one of the main purposes" of any person concerned with the creation or assignment of property in respect of which an amount is paid,[136] the PPT applies where it is "reasonable to conclude, having regard to all relevant facts and circumstances," that obtaining a treaty benefit was "one of the principal purposes" of a transaction or arrangement that resulted in a benefit under a CTA. As a result, the purpose test in the PPT adopts a lower threshold than most domestic GAARs which generally apply only where the sole or dominant purpose of a transaction or arrangement is to obtain a tax benefit,[137] and a lower threshold than the Canadian GAAR which applies where a transaction is undertaken or arranged "primarily" to obtain a tax benefit.[138]

Like the Canadian GAAR and unlike the guiding principle and limited purpose tests, on the other hand, the PPT refers to the purposes of a transaction or arrangement itself, rather than the purpose "for entering into" the transaction or arrangement or the purpose "of persons concerned" with a transaction or arrangement, suggesting a more objective analysis of the purposes of a transaction or arrangement, beyond the subjective intentions of the parties to these transactions

[135] Paragraph 61 of the commentary on article 1 of the 2017 OECD model convention
[136] See, e.g., articles 10(7), 11(9) and 12(8) of the Canada-UK tax treaty. Convention Between Canada and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed in London on September 8, 1978, and amended by Protocols signed on April 15, 1980, October 16, 1985, May 7, 2003, and July 21, 2014 (herein referred to as "the Canada-UK tax treaty").
[137] Paulo Rosenblatt and Manuel Tron, "General Report" 2018 IFA Congress, *Cahiers de droit fiscal international,* vol. 103 (Rotterdam: International Fiscal Association, 2018) 17 at 29-30.
[138] ITA, s. 245(3).

or arrangements. This objective analysis is reinforced by the use of the words "reasonable to conclude" in the PPT, which do not appear in the guiding principle or limited purpose tests in tax treaties, but are similar to the words "may reasonably be considered" which appear in the Canadian GAAR.

Unlike the Canadian GAAR, however, which *does not apply* where a transaction "may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit," the PPT *applies* where it is reasonable to conclude that one of the principal purposes of an arrangement or transaction was to obtain a benefit under a CTA. As a result, while the Canadian GAAR imposes an initial burden on taxpayers to provide a reasonable explanation as to why the primary purpose of a transaction was not to obtain a tax benefit which the revenue department must then refute, the PPT imposes an initial burden on the revenue authority to provide a reasonable explanation as to why one of the principal purposes of an arrangement or transaction was to obtain a benefit under a CTA which the taxpayer must refute.

This section examines each of the elements of the purpose test in the PPT, considering: (1) the concept of a purpose of a transaction or arrangement, (2) the meaning of "one of the principal purposes" of a transaction or arrangement, and (3) the effect of the words "reasonable to conclude" on the application of the purpose test.

(a) Purpose of a Transaction or Arrangement

Unlike anti-avoidance provisions in early tax treaties which referred to the intention of a taxpayer,[139] limited principal purposes tests which refer to the purpose of persons concerned with the creation or assignment of rights,[140] and the "guiding principle" which refers to a purpose "for entering into certain transactions or arrangements",[141] the PPT does not refer to the subjective intentions or purposes of parties to a transaction or arrangement but to the purposes of a transaction or arrangement itself. In this respect, the purpose test in the PPT is similar to the purpose test in the Canadian GAAR, which refers to the purpose of a transaction, rather than the purpose of the parties to a transaction.

Although it has been argued that reference to the purpose of a transaction suggests a purely objective test irrespective of the subjective purposes of parties to a transaction,[142] it is difficult to imagine that a transaction or arrangement could have transcendent purposes independent of the purposes of the parties to the transaction or arrangement.[143] On this basis, it follows that a purpose test based on the purposes of a transaction or arrangement is not entirely objective, but may take into account

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[139] See. e.g., article XI(2) of the 1942 Canada-US tax treaty, which denied the reduced withholding tax rate for dividends paid by a subsidiary to a parent company if "the competent authority" of the source state was "satisfied that the corporate relationship between the two corporations has been arranged or is maintained primarily with the intention of taking advantage of this paragraph." Convention Between Canada and the United States of America for the Avoidance of Double Taxation and the Establishment of Rules of Reciprocal Administrative Assistance in the Case of Income Taxes, signed at Washington, DC on March 4, 1942 (herein referred to as "the 1942 Canada-US tax treaty").

[140] See, e.g., articles 10(7), 11(9) and 12(8) of the Canada-UK tax treaty, *supra* note 136.

[141] Paragraph 61 of the commentary on article 1 of the 2017 OECD model convention

[142] Brian J. Arnold and James R. Wilson, "The General Anti-Avoidance Rule - Part 2" (1988), 34:5 *Can. Tax J.* 1123 at 1157. See also Carlos Palao Taboada, "OECD Base Erosion and Profit Shifting Action 6: The General Anti-Abuse Rule" (2015), 10 *Bulletin for International Taxation* 602 at 605, concluding that the purpose of a transaction "is not a quality pertaining to the will of a party to the transaction, but rather a legal attribute of the transaction itself."

[143] See David G. Duff, et. al. *Canadian Income Tax Law*, 6th ed. (Markham, LexisNexis, 2018) at 184, n. 64.

the specific circumstances of the persons who are parties to the transaction or arrangement.[144] The commentary on the OECD model convention is consistent with this conclusion, observing that is important to consider "the aims and objects *of all persons involved* in putting [an] arrangement or transaction into place or being a party to it."[145]

In assessing the purposes of a transaction or arrangement, on the other hand, courts consistently emphasize that they should not "be guided only by a taxpayer's statements, *ex post facto* or otherwise" but should instead look for "objective manifestations of purpose."[146] In this respect, as the Supreme Court of Canada has stated, "purpose is ultimately a question of fact, to be decided with due regard for all of the circumstances."[147] The commentary on the OECD model convention adopts a similar approach, stating that the purpose of an arrangement or transaction is "a question of fact, which can only be answered by considering all circumstances surrounding the arrangement or event on a case by case basis,"[148] and that a person cannot avoid application of the PPT "by merely asserting that the arrangement or transaction was not undertaken or arranged to obtain the benefits" of a tax treaty.[149]

Where a transaction results in a tax benefit, moreover, at least one Canadian tax case has held that the revenue authority may reasonably infer that a purpose of the transaction was to obtain this tax benefit, so that the taxpayer must offer an

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[144] *Ibid*.
[145] Paragraph 178 of the commentary on article 29 of the OECD model convention [emphasis added].
[146] *Symes v. Canada*, [1994] 1 C.T.C. 40, 94 D.T.C. 6001 (S.C.C.), at para. 74. See also *Groupe Honco Inc. v. Canada*, 2012 TCC 305 at para. 16 [hereafter *Group Honco Inc.*].
[147] *Symes*, *supra* note 146 at para 74. For this reason, it is mistaken to conclude that the purpose test in the PPT requires an assessment of "motives" which are "impossible to prove." Lang, *supra* note 82 at 658.
[148] Paragraph 178 of the commentary on article 29 of the OECD model convention.
[149] Paragraph 179 of the commentary on article 29 of the OECD model convention.

explanation that is "neither improbable nor unreasonable" to rebut this inference.[150] Since a purpose test clearly differs from a result test, however, the fact that a transaction results in a tax benefit is generally not itself sufficient to conclude that one of its purposes was to obtain this benefit.[151] The commentary on the OECD model convention arrives at the same conclusion, emphasizing that:

> It should not be lightly assumed … that obtaining a benefit under a tax treaty was one of the principal purposes of an arrangement or transaction and merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes.[152]

(b) One of the Principal Purposes of a Transaction or Arrangement

Like limited purpose tests in tax treaties which apply where "the main purpose or one of the main purposes" of any person concerned with the creation or assignment of property in respect of which an amount is paid is to obtain a treaty benefit,[153] the PPT applies where it is reasonable to concluded that "one of the principal purposes" of a transaction or arrangement is to obtain a benefit under a CTA. Similar language appears in the general anti-abuse rule of the EU Anti-Tax Avoidance Directive (ATAD),[154] and identical words appear in the anti-abuse rule in

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[150] *Placer Dome Inc. v. Canada*, [1977] 1 C.T.C. 72, 96 D.T.C. 6562 (F.C.A.) at para 21 [hereafter *Placer Dome*]. See also *Groupe Honco Inc.*, *supra* note 146 at para. 18, concluding that it is reasonable to consider "the inherent likelihood or probability of an event occurring" in assessing where one of the main purposes of a transaction or series of transactions was to obtain a dividend.

[151] *Placer Dome*, *supra* note 150 at para. 23, observing that "the term 'result' invites an objective appreciation of the factual circumstances" and concluding that the use of the word "purpose" in one context and "result" in another "requires that a different meaning be attributed to each."

[152] Paragraph 178 of the commentary on article 29 of the OECD model convention.

[153] See, e.g., articles 10(7), 11(9) and 12(8) of the Canada-UK tax treaty, *supra* note 136.

[154] Article 6(1) of EU Council Directive 2016/1164 (12 July 2016), providing that, for the purpose of calculating corporate tax liability, member states "shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances."

the EU Union Parent-Subsidiary Directive[155] and the discretionary relief provisions of the LOB rules in the MLI and the US model tax convention.[156] In contrast to these provisions, domestic GAARs generally apply only where the sole or dominant purpose of a transaction or arrangement is to obtain a tax benefit,[157] and the Canadian GAAR applies where a transaction is undertaken or arranged "primarily" to obtain a tax benefit.[158]

For this reason, the PPT has been subject to considerable criticism,[159] including the objection that the provision violates principles of legal certainty and proportionality under European law.[160] Although the argument that the PPT contradicts EU law seems overblown given similar language in the ATAD and identical language in the Parent-Subsidiary Directive,[161] there is no doubt that the

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155 EU Council Directive 2015/121 (27 January 2015), amending the EU Council Directive 2011/96/EU (30 November 2011), stipulating that member states "shall not grant the benefit of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all the facts or circumstances."

156 See article 7(12) of the MLI and article 22(6) of the US model tax convention, which authorize the competent authority of state to grant treaty benefits to a resident of the other state either generally or with respect to a specific item of income where, among other requirements, the resident demonstrates to the satisfaction of the competent authority that "neither its establishment, acquisition or maintenance, nor the conduct of its operations had as one of its principal purposes the obtaining of benefits" under the relevant tax treaty. United States, Department of the Treasury, Unites States Model Income Tax Convention, February 17, 2017 [herein referred to as the US model tax convention].

157 Rosenblatt and Tron, *supra* note 137 at 29-30

158 ITA, s. 245(3).

159 See, e.g., Lang, *supra* note 82 at 659-60; De Broe and Luts, *supra* note 65 at 145; Kużniacki, *supra* note 120 at 13-14; and Kok, *supra* note 93 at 408.

160 See, e.g., E.C.C.M. Kemmeren, "Where is EU Law in the OECD BEPS Discussion?" (2014), 23(4) *EC Tax Review* 190; and Luc De Broe, "Tax Treaty and EU Aspects of the LOB and PPT provision proposed by BEPS Action 6," in Robert Danon, ed., *Base Erosion and Profit Shifting: Impact for European and International Tax Policy*, (Geneva/Zurich: Shulthess, 2016) 197.

161 See, e.g., Philip Baker, "The BEPS Action Plan in light of EU Law: Treaty Abuse" [2015] *Brit. Tax Rev*. 408, referring to the language of the Parent-Subsidiary Directive; and Danon, *supra* note 69 at 45-48, referring to the ATAD and arguing that the PPT implicitly incorporates a "genuine economic activity" element that corresponds to EU law. For a more detailed analysis which concludes that the PPT does not contradict EU law, see Dennis Weber, "The Reasonableness Test of the Principal Purpose Test

PPT adopts a lower purpose threshold than most domestic GAARs and will therefore be easier for revenue authorities to apply than these anti-abuse provisions – a result which is presumably intended by contracting jurisdictions to the MLI given extensive criticism directed at this aspect of the PPT in comments on the BEPS Action 6 discussion draft.[162]

While the purpose test in the PPT is based on limited purpose tests in tax treaties, these limited purpose tests are themselves derived from domestic tax law in the United Kingdom, where several specific anti-avoidance rules apply where "one of the main objects" or "one of the main purposes" of a transaction or arrangement was to obtain a tax advantage.[163] Not surprisingly, given the influence of U.K. income tax law on Canadian income tax law,[164] similar purpose tests also appear in several specific anti-avoidance rules in Canada.[165]

Addressing this language in the context of a specific anti-avoidance rule, one UK case concluded that the concept of a main object or purpose "envisages … a range

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Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law," (2017) 10 *Erasmus Law Rev.* 48.

[162] Organisation for Economic Cooperation and Development, "Comments Received on Public Discussion Draft 'BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" (2014).

[163] Jonathan Schwarz, *Schwarz on Tax Treaties*, 3d ed., (London: CCH, 2013) at 421.

[164] Benjamin Alarie and David G. Duff, "The Legacy of UK Tax Concepts in Canadian Income Tax Law" Influence of U.K. Tax Law on Canadian Tax Law," [2008] *British Tax Rev.* 228.

[165] See, e.g., ITA, s. 83(2.1) which deems a dividend to be a taxable dividend and not a capital dividend where the dividend is paid on a share that was acquired by its holder in a transaction or as part of a series of transactions "one of the main purposes" of which was to receive the dividend: s. 94.1(1) which includes an amount in respect of offshore investment fund property, among other circumstances, where "one of the main reasons" for the taxpayer acquiring, holding or having an interest in this property was to derive a benefit from portfolio investments in such a manner that the taxes on income, profits against gains from such assets are significantly less than they would have been if the income, profits or gains had been earned directly by the taxpayer; and s. 256.1(6) which deems the attribute trading restrictions to apply as if control of one or more corporations were acquired where control of a particular corporation is acquired by a person or group of persons and it can reasonably be concluded that "one of the main reasons" for the acquisition of control is so that a specified provision does not apply to one or more corporations.

of objectives" which "must be assessed in some sort of priority or hierarchy" in order to determine "which are of sufficient significance to count as 'main' from those which are not."[166] Another case states that a main purpose is always "more than trivial" and "has a connotation of importance."[167] Other UK decisions have held that a tax advantage may be a main object or purpose of a transaction "even if the transaction … had a commercial objective at least as important" as the tax advantage,[168] and will necessarily be a main object or purpose of a transaction if the transaction is "so influenced by [its] tax effect" that is it "reasonable to assume that the tax effect must have been one of the main purposes" of the transaction[169] – for example if the transaction as structured would not have been undertaken but for the tax advantage.[170] Where transactions are entered into for a "genuine commercial purpose," on the other hand, and are not deliberately structured in way to obtain a tax advantage, the tax advantage cannot be regarded as a main object or purpose of the transaction.[171]

The commentary on the OECD model convention is broadly consistent with these judicial decisions, stating that the PPT may apply where "at least one of the principal purposes" of a transaction or arrangement was to obtain a benefit under a tax treaty, notwithstanding that there may also be other principal purposes for the

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[166] *Lloyds TSB Equipment Leasing (No. 1) Ltd. v. Commissioners for Her Majesty's Revenue and Customs*, [2012] UKFTT 47 (TC) at para. 388. This statement was affirmed by the Court of Appeal in *Commissioners for Her Majesty's Revenue and Customs v. Lloyds TSB Equipment Leasing (No. 1) Ltd.*, [2014] EWCA Civ 1062 at para. 52 [hereafter *Lloyd's TSB Equipment Leasing* (CA)].
[167] *Travel Document Service & Ladbroke Group International v. Commissioners for Her Majesty's Revenue & Customs*, [2018] EWCA Civ 549 at para. 48 48 [hereafter *Travel Document Service*].
[168] See, e.g., *Commissioners for Her Majesty's Revenue and Customs v. Lloyds TSB Equipment Leasing (No. 1) Ltd.*, [2013] UKUT 0368 (TCC) at para. 82 [hereafter *Lloyds TSB Equipment Leasing* (TCC)].
[169] *AH Field (Holdings) Ltd. v. Revenue and Customs*, [2012] TC 01800 at para. 126.
[170] *Ibid.* at para. 176.
[171] *Lloyd's TSB Equipment Leasing* (CA), *supra* note 166 at para. 65.

transaction or arrangement.[172] As a result, it explains, where a person sells property after changing residence and "one of the principal purposes" of this change "is to obtain a benefit under a tax convention," the PPT could apply "notwithstanding the fact that there may also be other principal purposes for changing residence, such as facilitating the sale of the property or the re-investment of the proceeds of the alienation."[173] In addition, it emphasizes, where an arrangement "can only be reasonably explained by a benefit that arises under a treaty," it necessarily follows that "one of the principal purposes of that arrangement was to obtain the benefit."[174]

In contrast, the commentary continues, a purpose will not be a principal purpose if:

> … it is reasonable to conclude, having regard to all the relevant facts and circumstances, that obtaining the benefit was not a principal consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit.[175]

As a result, it maintains, where a transaction or arrangement is "inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit."[176] For example, where a company resident in one state (RCO) establishes a manufacturing plant in a developing country "in order to benefit from

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[172] Paragraph 180 of the commentary on article 29 of the OECD model convention.
[173] *Ibid*. This example corresponds to the facts in *MIL Investments*, *supra* note 128, where the trial judge accepted the taxpayer's testimony that it continued into Luxembourg primarily for business reasons, notwithstanding a substantial tax benefit. As explained in the first part of this article, the taxpayer conceded that the continuation into Luxembourg was primarily tax-motivated on appeal, but the Federal Court of Appeal upheld the decision in any event on the grounds that the revenue authority failed to establish that the transactions were abusive.
[174] Paragraph 178 of the commentary on article 29 of the OECD model convention.
[175] Paragraph 181 of the commentary on article 29 of the OECD model convention.
[176] *Ibid*. Since the purpose test in the PPT refers not to "the principal purpose" of a transaction or arrangement but to "one of the principal purposes" of the transaction or arrangement, the words "its principal purpose" in this sentence should read "one of its principal purposes".

lower manufacturing costs", the commentary concludes that "the principal purposes for making that investment and building the plant are related to the expansion of RCO's business and the lower manufacturing costs of that country" – despite the fact that the decision to invest in the developing country was "taken in light of" the fact that the developing country was "the only one" of three countries considered with which the state in which RCO is resident has a tax treaty.[177]

To some commentators, this example and specific statements in the commentary on the OECD model convention suggest that the PPT should be applied only where the primary purpose of a transaction or arrangement is to obtain a treaty benefit, not where one of its principal purposes is to obtain the benefit.[178] Indeed, since the example indicates that investment was made in "the only one" of three countries with which the state in which RCO is resident has a tax treaty, it is not clear why obtaining treaty benefits was not "a principal purpose" of the investment, even though it seems reasonable to conclude that it was not the primary purpose of the investment.[179] The commentary is also poorly drafted in two paragraphs where it appears to suggest that the PPT can apply only where the principal purpose of a transaction or arrangement is to obtain a treaty benefit, not where one of the principal purposes of the transaction or arrangement is to obtain a treaty benefit.[180]

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[177] Example C in paragraph 182 of the commentary on article 29 of the OECD model convention.
[178] See, e.g., De Broe and Luts, *supra* note 65 at 145; and Vikram Chand, "The Principal Purpose Test in the Multilateral Convention: An In-Depth Analysis" (2018), 46 *Intertax* 18 at 23.
[179] As a result, the better reason why the PPT should not apply to this example is, as also stated in the commentary, that obtaining treaty benefits in this case would be "in accordance with the object and purpose of the provisions" of the tax treaty, which are "to encourage cross-border investment." Example C in paragraph 182 of the commentary on article 29 of the OECD model convention.
[180] See paragraph 174 of the commentary on article 29 of the OECD model convention, stating the purpose of the PPT is "to ensure that tax conventions apply in accordance with the purpose for which they were entered into, i.e. to provide benefits in respect of bona fide exchanges of goods and

Nonetheless, the conclusion that the PPT should apply only where the primary purpose of a transaction or arrangement is to obtain a treaty benefit is clearly at odds with the text of the PPT and with an explicit statement in the Commentary that the phrase "one of the principal purposes" means that "obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction."[181] As a result, despite the example and poorly drafted statements in the commentary on the OECD model convention, it is clear that the purpose test in the PPT is satisfied when "one of the principal purposes" of a transaction or arrangement is to obtain a treaty benefit.

More plausibly, however, the statement in the commentary that "it is unlikely" that a principal purpose of a transaction or arrangement is to obtain a benefit where the transaction or arrangement is "inextricably linked to a core commercial activity" suggests that the PPT may incorporate an implicit "genuine economic activity" exception that generally precludes its application to transactions or arrangements with real economic substance.[182] Indeed, this interpretation is supported by several examples in the commentary, including the earlier example of the manufacturing plant established in a developing country,[183] which conclude that transactions or arrangements with real economic substance would not be subject to

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services, and movements of capital and persons as opposed to arrangements whose *principal objective* is to secure a more favourable tax treatment" [emphasis added]; and paragraph 181 of the commentary on article 29 of the OECD model convention, concluding that where an arrangement is inextricably linked to a core commercial activity, it is unlikely that "its principal purpose" will be considered to be to obtain a treaty benefit

[181] Paragraph 180 of the commentary on article 29 of the OECD model convention.

[182] See, e.g., Danon, *supra* note 69 at 47;l and Chand, *supra* note 178 at 23.

[183] Example C in paragraph 182 of the commentary on article 29 of the OECD model convention, summarized at *supra* text accompanying note 177.

the PPT.[184] Although it may often be concluded in these circumstances that obtaining a treaty benefit was not a principal purpose of the transaction or arrangement,[185] the most persuasive reason for concluding that the PPT should not apply in these cases is (as explained below) that providing treaty benefits for transactions or arrangements with real economic substance is generally in accordance with the object and purpose of tax treaties.[186]

(c) Reasonableness of Conclusion

Although judicial decisions suggest that any purpose test must be assessed in light of objective manifestations of purpose,[187] the words "reasonable to conclude" in the PPT make this objective assessment explicit, confirming that the purpose test in the PPT, like the purpose test in the Canadian GAAR, considers "not what was in the particular taxpayer's mind but what a reasonable taxpayer would have considered the purpose of the transaction."[188] Interpreting similar language in the Canadian GAAR, the Federal Court of Appeal has held that "the focus will be on the relevant facts and circumstances and not on statements of intention."[189]

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[184] In addition to example C, see also examples G and K of paragraph 182 of the commentary on article 29 of the OECD model convention, and examples B and F of paragraph 187 of the commentary on article 29 of the OECD model commentary. These examples are discussed at *infra*, text accompanying notes 228-232.

[185] See, e.g., Danon, *supra* note 69 at 48, concluding that "substance is one of the key elements allowing the taxpayer to demonstrate that … obtaining the relevant treaty benefit is not one of the principal purposes of the arrangement or transaction that resulted directly or indirectly in that benefit".

[186] *Infra* at text accompanying notes 228-232.

[187] *Supra* text accompanying notes 146-149.

[188] Arnold and Wilson, *supra* note 142 at 1157.

[189] *OSFC Holdings Ltd. v. Canada*, [2001] F.C.J. No. 1381, [2001] 4 C.T.C. 82, 2001 D.T.C. 5471 (F.C.A.) at para. 46 [hereafter *OSFC*].

Similarly, the OECD Commentary states that "different interpretation of the events must be objectively considered,"[190] and the PPT itself states that the reasonableness of the conclusion that one of the principal purposes of an arrangement or transaction was to obtain a treaty benefit must be determined "having regard to all relevant facts and circumstances".[191] As well, the commentary on the OECD model convention states that a person cannot avoid application of the PPT "by merely asserting that the arrangement or transaction was not undertaken or arranged to obtain the benefits" of a tax treaty.[192] As a result, the PPT clearly requires an objective assessment of the purposes of the parties to the transaction or arrangement.[193]

Unlike the Canadian GAAR, however, which *does not apply* where a transaction may reasonably be considered to be undertaken or arranged primarily for *bona fide* purposes other than to obtain a tax benefit, the PPT *applies* where it is reasonable to conclude that one of the principal purposes of the transaction or arrangement was to obtain a benefit. As a result, while the GAAR places the onus on the taxpayer to disprove the underlying assumptions of fact on which the assessment is based, the PPT places the onus on the revenue authority to establish that a principal purpose of the transaction or arrangement was to obtain a treaty benefit.

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[190] Paragraph 179 of the commentary on article 29 of the OECD model convention

[191] Article 7(1) of the MLI.

[192] Paragraph 179 of the commentary on article 29 of the OECD model convention.

[193] See, e.g., Weber, *supra* note 161 at 49, observing that the "reasonableness test" requires "an objective analysis" of the facts and circumstances in order to determine the subjective intention of the taxpayer.

More significantly, the reasonableness language in each provision operates differently, resulting in a lower a lower burden for the revenue authority under the PPT than under the Canadian GAAR. Under the GAAR, the taxpayer must provide a reasonable explanation as to why the primary purpose of a transaction was not to obtain a tax benefit, which the revenue authority must then refute by clearly and unambiguously demonstrating that the primary purpose of the transaction was to obtain a tax benefit. In contrast, the PPT requires the revenue authority to provide a reasonable explanation as to why one of the principal purposes of an arrangement or transaction was to obtain a benefit under a CTA, which the taxpayer must then refute by clearly and unambiguously demonstrating that none of the principal purposes of the transaction or arrangement was to obtain the benefit.[194]

As a result, the PPT not only adopts a lower purpose threshold than the Canadian GAAR and most domestic GAARs, but effectively requires the taxpayer to argue that it would be unreasonable to conclude that a principal purpose of a transaction or arrangement was to obtain a benefit under a CTA.[195] Since this may be difficult to establish in the context of cross-border transactions or arrangements for which tax implications are typically taken into account,[196] the purpose test in the PPT may be relatively easy to satisfy, as a result of which application of the PPT will

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[194] See, e.g., Lang, *supra* note 82 at 658, concluding that this requirement is "not too demanding" since the revenue department's argument need only be "reasonable" not "compelling".
[195] See, e.g., DeBroe and Luts, *supra* note 65 at 145, concluding on this basis that the purpose threshold in the PPT "is set extremely low".
[196] See, e.g., Erik Pinetz, "Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse" (2016), 70 *Bulletin for International Taxation* 113 at 11; and Ansh Bhargava, "The Principal Purpose Test: Functioning, Elements and Legal Relevance" in Daniel W. Blum and Markus Seiler, eds., *Preventing Treaty Abuse*, (Vienna: Linde, 2016) 311 at 318..

turn primarily on whether granting the benefit is in accordance the object and purpose of the relevant provisions of the CTA.[197]

(3) Object and Purpose Test

Where the result test and the purpose test are satisfied, the PPT applies to deny a treaty benefit "unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions" of the CTA. Similarly, the guiding principle applies only where obtaining a more favourable tax position "would be contrary to the object and purpose of the relevant provisions" of a tax treaty,[198] and the Canadian GAAR applies only if it may reasonably be considered that the transaction results in a misuse of provisions of the ITA or other relevant enactments or an abuse having regard to these provisions read as a whole[199] – which entails an inquiry into the object and purpose of these provisions.[200]

In contrast to the object and purpose tests in the guiding principle and the Canadian GAAR, however, which constitute *an additional requirement* that must be satisfied if benefits that would otherwise be available are to be denied, the object and purpose test in the PPT operates as *an exception* to the general anti-abuse rule, allowing treaty benefits that would otherwise be denied by the provision. As a result, while the object and purpose tests in the guiding principle and the Canadian GAAR

[197] See, e.g., Lang *supra* note 82 at 658-59, suggesting on this basis that the purpose test in the PPT "runs the risk of not gaining any significance in itself."
[198] Paragraph 61 of the commentary on article 1 of the 2017 OECD model convention.
[199] ITA, s. 245(4).
[200] See, e.g., *Copthorne Holdings*, *supra* note 107 at para. 55, explaining that the characterization of an avoidance transaction as abusive is ultimately a matter of statutory interpretation, in which a court must first "determine the object, spirit or purpose of the provisions" that are relied upon in order to obtain the tax benefit, and then decide whether the transaction defeats or frustrates this identified purpose.

require the revenue authorities to establish that a benefit that a taxpayer would otherwise obtain would contradict the object and purpose of relevant provisions, the PPT requires the taxpayer to establish that a benefit that would otherwise be denied should be allowed because it is in accordance with the object and purpose of the relevant provisions of a CTA.

This section examines each of the elements of the object and purpose test in the PPT, considering: (1) the identification of "relevant provisions" of a CTA, (2) whether the treaty benefit is in accordance with the "object and purpose" of these provisions, and (3) the effect of making the object and purpose test an exception to the general anti-abuse rule.

(a) Relevant Provisions

In order to determine whether a benefit that would otherwise be denied under the PPT may be granted under the object and purposes exception, it is first necessary to identify the "provisions" of the CTA that are "relevant" to this object and purpose test. Although the meaning of a "relevant provision" is neither defined in the MLI nor discussed in the OECD Commentary, this concept necessarily includes the specific provision that is relied upon in order to obtain the benefit under the CTA – for example, the article of a CTA that provides a reduced withholding tax rate or exemption from source taxation. Where a company increases its shareholding in another company in order to obtain a lower withholding tax rate on dividends, for example, the treaty provision under which this lower rate is granted is obviously relevant to the object and purpose test.[201] Likewise, where person splits up a contract in order to avoid permanent establishment status for a building site or construction or installation project, the treaty provision that excludes short-term contracts from permanent establishment status is clearly relevant to the object and purpose test.[202]

As well, where a person carries out a transaction or arrangement in order to circumvent the application of another treaty provision, this other provision is presumably also relevant to the object and purpose test. For example, where a person contributes assets to a corporation in order to circumvent a substituted property rule like article 13(4) of the OECD model convention, this provision is at least as relevant to an object and purpose analysis as the general treaty provision that exempts gains from taxation in the source state that is actually relied upon in order to obtain the treaty benefit.

In addition, although the PPT refers only to the object and purpose of "relevant provisions" of a CTA and not the object and purpose of the CTA as a whole or of the provisions of the CTA read as a whole,[203] these are undoubtedly also

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[201] See example E in paragraph 182 of the commentary on article 29 of the OECD model convention, concluding that an increase in a company's shareholding in order to obtain a reduced withholding tax rate under article 10(2)(a) of the OECD model convention was in accordance with the object and purpose of this provision.

[202] See example J in paragraph 182 of the commentary on article 29 of the OECD model convention, concluding that the splitting-up of a contract in order to avoid permanent establishment status was contrary to the object and purpose of article 5(3) of the OECD model convention.

[203] In this respect, the PPT (and the guiding principle) differ from the Canadian GAAR, which contemplates a misuse of provisions of the ITA and other relevant enactments and an abuse "having regard to those provisions, other than this section, read as a whole." ITA, s. 245(4). In *OSFC*, *supra* note 189 at para. 64, the Federal Court of Appeal held that this language contemplates "an object and spirit, or policy, analysis of the provisions in question or the provisions of the *Act* read as a whole" – with one level of analysis directed at the specific provisions at issue and another level of analysis concerned with the broader purpose, scheme or policy of the ITA as a whole. In *Canada Trustco, supra* note 70, however, the Supreme Court of Canada rejected this two-level analysis, concluding (at para.

relevant to an object and purpose analysis, since the object and purpose of a tax treaty is necessarily realized through its specific provisions and the object and purpose of specific provisions are presumably intended to fulfill the object and purpose of the treaty as a whole.[204] Indeed, although it is arguable that the preamble of a CTA is not technically a "provision" of a CTA, it would be absurd to assume that the preamble is not a "relevant provision" for the purposes of the object and purpose test in the PPT, particularly since the amended preamble language in article 6(1) of the MLI is clearly intended to influence the interpretation of provisions of a CTA,[205] including the PPT.[206] As a result, although relevance of the provisions of a CTA as a whole to the application of the PPT is not as clear as it might be if the PPT specifically referred to the object and purpose of relevant provisions of the CTA and the

43) that the GAAR "requires a single, unified approach to the … interpretation of the specific provisions of the *Income Tax Act* that are relied upon by the taxpayer in order to determine whether there was abusive tax avoidance." Although the Supreme Court of Canada's subsequent decision in *Copthorne Holdings*, *supra* note 107, reaffirmed this "unified" approach, it appears to have broadened the scope of the misuse or abuse analysis to include not only "the specific provisions … relied upon by the taxpayer" to obtain a tax benefit but also other provisions that necessary to understand the statutory scheme.

[204] See, e.g., De Broe, *International Tax Planning and the Prevention of Abuse*, *supra* note 115 at 330; Kok, *supra* note 93 at 409, stating that "the 'object and purpose' of a treaty provision has to be interpreted in light of the 'object and purpose' of the treaty in general"; Danon, *supra* note 69 at 45, observing that "it is generally not obvious to assign a specific purpose to treaty provisions such as the distributive rules whose general objective is simply to allocate taxing rights with a view to eliminating double taxation"; and Chand, *supra* note 178 at 26, concluding that "the object and purpose of the 'relevant provisions' have to be read in light of the object and purpose of the entire tax treaty."

[205] See paragraph 16.2 of the introduction to the commentary on the OECD model convention, emphasizing that the title and preamble of the OECD Model Convention "form part of the context of the Convention and constitute a general statement of the object and purpose of the Convention," and should therefore "play an important role in the interpretation of the provisions of the Convention."

[206] See paragraph 173 of the commentary on article 29 of the OECD model convention, emphasizing that the PPT "must be read in the context of [the limitation on benefit provisions in] paragraphs 1 to 7 and of the rest of the Convention, *including the Preamble*." [emphasis added] According to the commentary, "[t]his is particularly important for determining the object and purpose of the relevant provisions of the Convention."

provisions of the CTA read as a whole,[207] it is not surprising that several of the tax treaty-shopping examples in the commentary on the OECD model convention refer to the object and purpose of the tax convention as a whole rather than the object and purpose of specific provisions under which treaty benefits are conferred.[208]

Less clear, though potentially also relevant to an object and purpose analysis, are provisions of the MLI or model tax treaties that are *not* included in the particular CTA – for example, the simplified LOB provisions in articles 7(8)-(13) of the MLI, the specific anti-avoidance rule for dividend transfer transactions in article 8(1) of the MLI, or the anti-avoidance rule for capital gains from the alienation of shares or comparable interests deriving their value principally from immovable property in article 9(1) of the MLI. Although it might be argued that an absence of agreement on the inclusion of these provisions in a CTA evidences an intention on the part of the contracting jurisdictions to permit arrangements or transactions that might otherwise be prohibited by these provisions,[209] it is also arguable that the contracting jurisdictions intended to rely on the more general language of the PPT to challenge these transactions or arrangements without adopting the detailed

[207] On this point, see Danon, *supra* note 69 at 45, suggesting that there is "an inherent conceptual difficulty to apply the PPT rule which may entail uncertainties if the decision to deny treaty benefits is simply made on the basis of a general purpose of the treaty as modified by the MLI."
[208] See, e.g., examples A, B, and C in paragraph 182 of the commentary on article 29 of the OECD model convention, concluding that the "treaty-shopping arrangements" in Examples A and B "would be contrary to the object and purpose of the tax convention" whereas the selection of a state in which to establish a manufacturing plant "in light of" a tax treaty would be "in accordance with the object and purpose of provisions of that convention" because "a general objective of tax conventions is to encourage cross-border investment". See also Examples D and K in paragraph 182 of the commentary on article 29 of the OECD model convention, which conclude that the PPT would not apply in large part because the "intent of tax treaties" is "to provide benefits to encourage cross-border investment".
[209] See, e.g., Kok, *supra* note 93 at 411, arguing that the PPT should not apply to deny a treaty benefit resulting from a dividend transfer transaction if the dividend article does not include a minimum shareholding period. For a judicial example of this approach, see *Knights of Columbus*, *supra* note 84.

limitations of these SAARs.[210] Either way, as discussed earlier in addressing the relationship between the PPT and specific anti-avoidance rules,[211] the absence of a provision that might otherwise be included in a CTA could be relevant to the object and purpose analysis.

(b) Treaty Benefit in Accordance with Object and Purpose of Relevant Provisions

Once the "relevant provisions" are identified, it is necessary to determine their objects and purposes in order to decide whether granting a benefit that might otherwise be denied under the PPT is in accordance with these object and purposes. As with the misuse or abuse analysis under the Canadian GAAR, this process can be divided into two analytical stages: first, identifying the objects and purposes or "policy" of the relevant provisions; second, assessing the facts of the transaction or arrangement to determine whether granting a benefit in these circumstances is in accordance with these objects and purposes.[212]

As also with the misuse and abuse analysis under the Canadian GAAR, the first of these stages involves an interpretive exercise that differs from the ordinary interpretation of a statute or a treaty, since its aim is not to determine the meaning of the relevant provisions in light of their objects and purposes, but to determine "the rationale that underlies the words" of these provisions, which "may or may not

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[210] See, e.g., Danon, *supra* note 69 at 43, concluding that "[w]here a state has reserved the right not to apply" the specific anti-abuse rules in articles 8(1) and 9(1) of the MLI, "the PPT would thus apply by default to those situations."

[211] *Supra* notes 84-100 and accompanying text under the heading "Relevance of Specific Treaty Anti-Abuse Rules not Included in a CTA".

[212] This "two-stage analytical process" was adopted in *OSFC*, *supra* note 189 at para. 67, and endorsed by the Supreme Court of Canada in *Canada Trustco*, *supra* note 70 at para. 44. Chand also considers this two-stage analysis appropriate for the object and purpose test in the PPT. Chand, *supra* note 178 at 26.

be captured by the … words" of the provisions themselves.[213] For this reason, it is wrong to conclude that the object and purpose test in the PPT simply incorporates ordinary principles of treaty interpretation, which must always consider the objects and purposes of treaty provisions.[214]

(i) Interpreting the Object and Purpose of a Treaty Provision

In order to interpret the object and purpose of a treaty provision, it is always necessary to consider the text of the provision,[215] construing its rationale or policy in the context of other treaty provisions including the preamble, as well as extrinsic materials such as explanatory memoranda and commentaries (provided that the commentaries are not subject to any relevant reservations).[216] While the text of a treaty provision may not fully capture its object and purpose, it often provides some basis on which its object and purpose may reasonably be inferred, particularly when the provision is read in the context of other provisions.

For example, although article 5(3) of the OECD model convention states only that "[a] building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months", it is reasonable to conclude that the object or purpose of this provision is to exclude short-term building or construction or installation projects from source taxation of business profits that

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[213] *Copthorne Holdings*, *supra* note 107 at para. 70, explaining that "traditional statutory interpretation" seeks to determine the meaning of a statutory text, while a misuse or abuse analysis under the GAAR seeks "the rationale that underlies the words that may or may not be captured by the bare meaning of the words."

[214] Lang, *supra* note 82 at 661, referring to article 31(1) of the *Vienna Convention on the Law of Treaties*. Signed at Vienna on May 23, 1969, UN doc. A/Conf. 39/27, fourth annex, UNTS 1155/331.

[215] Frank Engelen, *Interpretation of Tax Treaties under International Law*, (Amsterdam: IBFD, 2004) at 175.

[216] Kok, *supra* note 93 at 409. On the relevance of interpretative memoranda and commentaries on the OECD model convention to the interpretation of Canada's tax treaties, see *Crown Forest Industries Ltd. v. Canada*, [1995] 2 C.T.C. 64, 95 D.T.C. 5389 (S.C.C.).

would otherwise be permitted under article 7(1) of the OECD model convention if the project were characterized as a permanent establishment. Likewise, although the substituted property rule in article 13(4) of the OECD model convention does not explicitly say so, it is reasonable to infer from its text and its relationship to articles 13(1) and (5) of the OECD model convention that its object or purpose is "to prevent the non-taxation by the source state of capital gains derived principally from immovable property situated in the source state."[217]

In other circumstances, the object and purpose of a provision may be suggested by the text and clarified by extrinsic materials. According to the commentary on the OECD model convention, for example, the reduced withholding tax rate on dividends under article 10(2)(a) of the convention is intended to impose a lower tax on "dividends paid by a subsidiary company to its parent company" in order "to avoid recurrent taxation and facilitate international investment."[218] The commentary also explains that the object and purpose of article 15(2) of the OECD model convention is:

> … to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the State of source because the employer is not taxable in that State as it neither is a resident nor has a permanent establishment therein.[219]

In each of these cases, the commentary confirms a plausible interpretation that might reasonably be inferred from the text of the provisions themselves.

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[217] *Alta Energy Luxembourg S.A.R.L. v. The Queen*, [2018] T.C.C. 152 [hereafter *Alta Energy*] at para. 41, observing that: "Absent this rule, it would be possible … to conduct a share sale instead of an asset sale to avoid taxation in the source state."

[218] Paragraph 10 of the commentary on article 10 of the OECD model convention.

[219] Paragraph 6.2 of the commentary on article 15 of the OECD model convention, adding that the provision "can also be justified by the fact that imposing source deduction requirements with respect to short-term employments in a given State may be considered to constitute an excessive administrative burden where the employer neither resides nor has a permanent establishment in that State."

Where the text of a treaty provision does not itself suggest specific rationale, on the other hand, its object and purpose can generally be construed in light of the objects and purposes of the treaty as a whole. Although the specific object and purpose of each distributive rule in a tax treaty may not be immediately obvious, for example, the overall object and purpose of these provisions is generally understood to be to allocate taxing rights among contracting states in a fair and reasonable manner in order to encourage cross-border economic activity by reducing or eliminating economic double taxation.[220] As the U.S. Fifth Circuit court stated in *Johansson v. United States*,[221] the "primary objective" of tax treaties is to eliminate "impediments to international commerce resulting from the double taxation of international transactions" by allocating tax jurisdiction to the "most appropriate locus for the taxation of any given transaction." Consistent with these objects and purposes, the title to the 2017 OECD model convention explicitly states that one of its purposes is "the elimination of double taxation with respect to taxes on income and capital" and the preamble to this model states among other things that the contracting states desire "to further develop their economic relationship".[222]

In addition to these established objects and purposes, however, it is also generally accepted that tax treaties are not intended to facilitate tax avoidance,[223]

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[220] See, e.g., De Broe, *International Tax Planning and the Prevention of Abuse*, *supra* note 115 at 344.
[221] 336 F.2d 809 (5th Cir. 1964) at 813.
[222] Although the MLI does not include a provision to modify the title of CTAs, contracting jurisdictions may adopt optional preamble language in article 6(3) expressing a desire "to further develop their economic relationship". Of eighty-four signatories to the MLI as of 18 September 2018, fifty-five (not including Canada) had adopted this optional preamble language. Since encouraging economic relationships among contracting states is a well-recognized object and purpose of tax treaties, it is not clear that this preamble language will have any impact on the interpretation of tax treaties generally or the PPT in particular.
[223] See, e.g.,De Broe, *International Tax Planning and the Prevention of Abuse*, *supra* note 115 at 337.

and the preamble to the 2017 OECD model convention and article 6(1) of the MLI explicitly state that CTAs are not intended to create "opportunities for non-taxation or reduced taxation through tax … avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)." In construing the objects and purposes of a CTA that is modified by this preamble language, therefore, it is necessary to consider not only the primary aim of the CTA to encourage cross-border economic activity by allocating taxing rights in a fair and reasonable manner in order to reduce or eliminate double taxation, but also the intention of the contracting jurisdictions that the CTA not create opportunities for non-taxation or reduced taxation through tax treaty shopping and other forms of tax avoidance. For this reason, when interpreting the object and purpose of a CTA that is modified by this preamble language, it is no longer possible to conclude, as the Supreme Court of India did in the context of the India-Mauritius Tax Treaty, that treaty shopping is necessarily consistent with the object and purpose of tax treaties because it encourages capital and technology inflows.[224]

Finally, it is notable that the commentary on the OECD model convention states that the purpose of the PPT is:

> … to ensure that tax conventions apply in accordance with the purpose for which they were entered into, i.e. to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.[225]

[224] *Union of India v. Azadi Bachao Andolan*, (2003), 6 ITLR 233 (S.C.), available at https://indiankanoon.org/doc/1960330/. This case is discussed in the first part of this article.
[225] Paragraph 174 of the commentary on article 29 of the OECD model convention.

Although this statement wrongly refers to the "principal objective" of an arrangement (as opposed to "one of its principal purposes") and appears to erroneously conflate the PPT's object and purpose test with its purpose test by stating that it would be contrary to the object and purpose of a treaty to provide benefits for arrangements whose principal objective is to obtain these benefits, a more plausible interpretation is that the primary purpose of a CTA with the amended preamble language is not simply to allocate taxing rights in order to encourage cross-border economic activity by reducing or eliminating double taxation, but to do so in a way that encourages bona fide or genuine cross-border economic activities rather than tax-motivated transactions or arrangements with little or no economic substance. Indeed, examples in the commentary on the OECD model convention provide further confirmation that providing treaty benefits for bona fide transactions or arrangements with real economic substance is generally in accordance with the object and purpose of tax treaties, even if one of the purposes or even a principal purpose of these transactions or arrangements is to obtain treaty benefits.

(ii) Assessing the Facts

Having determined the objects and purposes of the relevant provisions, application of the object and purpose test in the PPT depends on a factual assessment of the transactions or arrangements at issue in order to determine whether granting a benefit is in accordance with these objects and purposes. For treaty-shopping transactions or arrangements, which could otherwise enable a person to obtain a variety of treaty benefits, this assessment will generally relate to the objects and purposes of the treaty as a whole – asking whether granting a treaty benefit is in accordance with the primary purpose of the treaty to encourage genuine cross-border economic activity by allocating taxing rights and reducing or eliminating double taxation, without creating opportunities for non-taxation or reduced taxation through tax avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions). For rule-shopping transactions or arrangements, on the other hand, this factual assessment is more likely to address the objects and purposes of specific treaty provisions, the formal requirements of which are either satisfied or circumvented by a particular transaction or arrangement – asking whether granting a treaty benefit in these circumstances is in accordance with the objects and purposes of these provisions.[226] Although these factual assessments necessarily depend on the specific circumstances of the transactions or arrangements at issue, at least some guidance on the possible application of the object and purpose test may be drawn from examples in the commentary on the OECD model convention as well as cases discussed in the first part of this article.[227]

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[226] In this circumstance, the analysis is similar to the second-stage of the misuse and abuse analysis under the Canadian GAAR, determining whether a transaction or arrangement (1) achieves an outcome that the relevant provisions seek to prevent; (2) defeats the underlying rationale of the relevant provisions; or (3) circumvents the relevant provisions in a manner that frustrates or defeats their object or purpose. See *Canada Trustco*, *supra* note 70 at para. 45; reaffirmed in *Copthorne Holdings*, *supra* note 107 at para. 71.

[227] For a detailed discussion of the examples in the commentary on the OECD model convention, see Chand, *supra* note 178 at 27-38.

(A) Tax Treaty Shopping

Beginning with tax treaty shopping, it is notable that examples in the commentary on the OECD model convention consistently suggest that the PPT would not apply to transactions or arrangements that involve genuine cross-border economic activities. In the earlier example of a company resident in State R that establishes a manufacturing plant in the only one of three developing countries with which State R has a tax treaty, the commentary concludes that this investment would be "in accordance with the object and purpose of the provisions of that convention" because "a general objective of tax conventions is to encourage cross-border investment".[228] Likewise, in an example involving an institutional investor in State T, which establishes a wholly-owned subsidiary (RCO) in State R, which invests in a company (SCO) resident in State S, with which State R has a more advantageous tax treaty than State T, the commentary observes that "[t]he intent of tax treaties is to provide benefits to encourage cross-border investment" and concludes that the PPT would not apply, even though the decision to establish RCO in State R is driven partly by "the extensive tax convention network of State R, including its tax convention with State S, which provides for low withholding tax rates" because of the following factors:

> (1) the decision to establish RCO is also driven by "the availability of directors with knowledge of regional business practices and regulations, the existence of a skilled multilingual workforce, and State R's membership in a regional grouping";
>
> (2) "RCO employs an experienced local management team to review investment recommendations from Fund and performs various other functions which, depending on the case, may include approving and

[228] Example C in paragraph 182 of the commentary on article 29 of the OECD model convention.

> monitoring investments, carrying out treasury functions, maintaining RCO's book and records, and ensuring compliance with regulatory requirements in States where it invests";
>
> (3) RCO's board of directors "is… composed of a majority of State R resident directors with expertise in investment management"; and
>
> (4) the investment in SCO "would constitute only a part of RCO's overall investment portfolio, which includes investments in a number of countries in addition to State S which are also members o the same regional grouping."[229]

In another example, where a company resident in one state establishes a regional company (RCO) in State R with a comprehensive tax treaty network in order to provide group services to subsidiaries that are resident in other states, the commentary concludes that the PPT should not apply to deny the benefits of the tax treaties concluded between State R and the states in which the subsidiaries reside, provided that:

> … the intra-group services to be provided by RCO, including the making of decisions necessary for the conduct of its business, constitute a real business through which RCO exercises substantive economic functions, using real assets and assuming real risks, and that business is carried on by RCO through its own personnel located in State R,

unless other facts "indicate that RCO has been established for other tax purposes" or "RCO enters into specific transactions to which [the PPT] would otherwise apply."[230] Similarly, where the parent company of a worldwide group (TCO) that is resident in State T lends funds to a finance subsidiary (RCO) in State R, which lends the same amount on the same day at the same interest rate to a company (SCO) that is a member of the worldwide group and resident in State S, with which R has a tax treaty but T does not have a tax treaty, the commentary concludes that the back to

[229] Example K in paragraph 182 of the commentary on article 29 of the OECD model convention
[230] Example G in paragraph 182 of the commentary on article 29 of the OECD model convention.

back loans "do not constitute a conduit arrangement" to which the PPT or anti-conduit provisions should apply because:

> (1) RCO carries on a "normal treasury business" for TCO, "coordinating the financing of all the subsidiaries of TCO", "maintain[ing] a centralized cash management accounting system for TCO and its subsidiaries … disbursing or receiving any cash payments required by transactions between its affiliates and unrelated parties" and "enter[ing] into interest rate and foreign exchange contracts as necessary to manage the risks arising from mismatches in incoming and outgoing cash flows";
>
> (2) RCO's activities "are intended (and reasonably can be expected) to reduce transaction costs and overhead and other fixed costs)";
>
> (3) "RCO has 50 employees, including clerical and other back office personnel, located in State R [reflecting] the size of the business activities of RCO";
>
> (4) RCO therefore "appears to be carrying on a real business performing substantive economic functions, using real assets and assuming real risks";
>
> (5) RCO performs "significant activities with respect to the transactions with TCO and SCO, which appear to be typical of RCO's normal treasury business"; and
>
> (6) "RCO appears to be bearing the interest rate and currency risk."[231]

In yet another example, where a manufacturing company (RCO) resident in State R, the shares of which are wholly owned by a company (TCO) resident in State T, establishes a subsidiary (SCO) in order to act as its exclusive distributor in State S, with which T does not have a tax treaty, the commentary also concludes that the arrangement would not be regarded as a conduit arrangement because the example involves "a normal commercial structure where RCO and SCO carry on real economic

[231] Example F in paragraph 187 of the commentary on article 29 of the OECD model convention.

activities in States R and S" and "[t]he payment of dividends by subsidiaries such as SCO is a normal business transaction."[232]

In contrast, where transactions or arrangements have little or no real economic substance, the commentary on the OECD Model Convention concludes that the PPT or anti-conduit provisions should apply to deny treaty benefits. In one example, based on the *Royal Dutch Oil Company* case,[233] a company (TCO) resident in State T which owns shares of a company (SCO) resident in State S, with which State T does not have a tax treaty, assigns the right to dividends that have been declared but not yet paid by SCO to RCO, an independent financial institution resident in State R, which has a tax treaty with State S that exempts dividends from withholding tax.[234] In this circumstance, the commentary concludes that:

> … it would be reasonable to conclude that one of the principal purposes for the arrangement … was for RCO to obtain the benefit of the exemption from source taxation of dividends provided for by the State R – State S tax convention and *it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement.*[235]

In another example, based on the *Bank of Scotland* case,[236] a company (TCO) resident in State T which has a wholly owned subsidiary (SCO) resident in State S, with which State T does not have a tax treaty, enters into an agreement with a financial institution (RCO) in State R, with which State S has a tax treaty under which the withholding tax rate on dividends is reduced to 5 percent from the domestic rate of 25 percent.[237] Under this agreement, RCO acquires the usufruct of newly-issued

[232] Example B in paragraph 187 of the commentary on article 29 of the OECD model convention
[233] *Supra* note 126. This case is discussed in the first part of this article.
[234] Example A in paragraph 182 of the commentary on article 29 of the OECD model convention.
[235] *Ibid*. [emphasis added]
[236] *Supra* note 127. This case is discussed in the first part of this article.
[237] Example B in paragraph 182 of the commentary on article 29 of the OECD model convention.

preferred shares of SCO for a period of three years in exchange for the present value of the dividends to be paid on the preferred shares over three years, discounted at the rate at which TCO could borrow from RCO. In this circumstance as well, the commentary concludes that:

> … it would be reasonable to conclude that one of the principal purposes for the arrangement … was to obtain the benefit of the 5 per cent limitation applicable to the source taxation of dividends provided for by the State R – State S tax convention and *it would be contrary to the object and purpose of the tax convention to grant the benefit of that limitation under this treaty-shopping arrangement*.[238]

Yet another example, based on *Aiken Industries Inc. v. Commissioner*,[239] involves a company (TCO) resident in State T which loans funds at a rate of 7 percent to a wholly owned subsidiary (SCO) in State S, which does not have a tax treaty with State T, and then assigns the debt to another wholly-owned subsidiary (RCO) in State R, with which State S has a tax treaty, in exchange for a note paying interest at a rate of 6 percent.[240] Emphasizing that the assignment "was structured to eliminate the withholding tax that TCO would otherwise have paid to State S", the commentary concludes that the transaction "constitutes a conduit arrangement" to which the PPT or anti-conduit provisions should apply.[241]

In addition to the specific cases on which they are based, these examples suggest that the PPT could also apply to transactions or arrangements like those in

[238] *Ibid*. [emphasis added]
[239] 56 T.C. 925 (1971) [hereafter *Aiken Industries*]. This case is discussed in the first part of this article.
[240] Example C in paragraph 187 of the commentary on article 29 of the OECD model convention. This example differs slightly from the facts in *Aiken Industries*, *supra* note 239, where the debt was assigned for a note paying interest at the same rate as the original loan. If the debt were assigned for a note paying interest at the same rate as the original loan, it is likely that the original lender TCO, rather than RCO, would be regarded as the beneficial owner of the interest.
[241] *Ibid*.

Del Commercial Properties, Inc. v. Commissioner of Internal Revenue,[242] *X Holdings ApS v. Federal Tax Administration*,[243] the *VSA* case,[244] and the *HHU* and *Cook* cases,[245] in which companies with little or no economic substance were established in order to obtain treaty benefits that would otherwise have been unavailable. They also suggest that the PPT could apply to transactions or arrangements like those in *Northern Indiana Public Service Corp. v. Commissioner*,[246] *Prévost Car*,[247] *Velcro*,[248] and the Spanish cases involving payments by the Real Madrid football team to Hungarian companies for the image rights of various team members,[249] in which companies to which interest, dividends or royalties were paid appear to have earned some profits on the spread between amounts received and amounts paid as well as reinvested profits, but otherwise conducted little or no business activity. In contrast, it seems less likely that the PPT should apply to payments such as those in the Swiss Swap case which are designed to hedge against swap payments – at least where these

[242] T.C. Memo 1999-411, aff'd 251 F.3d 210 (D.C. Cir. 2001), denying treaty benefits on the basis of a domestic substance over form doctrine. This case is discussed in the first part of this article.
[243] (2005) 8 ITLR 536, denying treaty benefits on the basis of an implicit anti-abuse principle. This case is discussed in the first part of this article.
[244] Swiss Commission of Appeals in Tax Matters, 28 February 2001, 4 *ILTS* 2002, 191, denying treaty benefits on the grounds that the recipient of dividends was not their beneficial owner. This case is discussed in the first part of this article.
[245] SKM 2011.57 LSR, and SKM 2011.485 LSR, denying treaty benefits on the grounds that the recipients of interest payments were not their beneficial owners. These cases are discussed in the first part of this article.
[246] 115 F.3d 506 (7th Cir. 1997), allowing treaty benefits on the basis that a wholly-owned finance subsidiary incorporated by the taxpayer had conducted "recognizable" though "concededly minimal" business activity, earning a profit from the spread between interest paid on Euronotes and interest charged to the taxpayer as well as reinvested profits. This case is discussed in the first part of this article.
[247] *Supra* note 124, allowing treaty benefits on the basis that the recipient of dividends was their beneficial owner. This case is discussed in the first part of this article.
[248] *Supra* note 125, allowing treaty benefits on the basis that the recipient of royalty payments was their beneficial owner. This case is discussed in the first part of this article.
[249] AN 18 July 2006, JUR\2006\204307, JUR\2007\8915 and JUR\2007\6549; AN 10 Nov. 2006 JUR\2006\284679; AN 20 July 2006, JUR\2007\6526; AN 13 Nov. 2006, JUR\200\284618; and AN 26 Mar. 2007, JUR\2007\101877, denying treaty benefits on the basis that the recipients of the royalty payments were not their beneficial owners. This case is discussed in the first part of this article.

arrangements represent genuine business activities carried out by a financial institution.[250]

Less clear are transactions or arrangements involving tax-motivated changes of residence, which the commentary on the OECD model convention states "may" or "could" be subject to the PPT,[251] without explicitly discussing circumstances in which these transactions or arrangements might or might not be in accordance with the object and purpose of the relevant provisions of a tax treaty.[252] If the primary purpose of tax treaties is to encourage *genuine* cross-border economic activities, however, it might be reasonable to conclude a change of residence with real economic substance should not be subject to the PPT, even if one of the principal purposes of this change was to obtain a treaty benefit. This might be the case, for example, with a change of residence by an individual, at least to the extent that it requires a real social and economic presence.[253]

In contrast, where a corporation changes its residence by continuing from one jurisdiction to another or by changing its place of effective management, it is less certain that this transaction or arrangement would have sufficient economic substance to conclude that obtaining treaty benefits would be in accordance with the object and purpose of the relevant provisions of a treaty – particularly if the change

[250] CH: Federal Supreme Court (FSC), 5 May 2015, BGE 141 II 447, no. 2C_364/2012 [herein referred to as the Swiss Swap case], concluding that the recipient of payments from investments designed to hedge against swap payments was not the beneficial owner of the payments. This case is discussed in the first part of this article.
[251] Paragraphs 177 and 180 of the commentary on article 29 of the OECD model convention.
[252] Kok, *supra* note 93 at 411.
[253] David G. Duff, "Responses to Tax Treaty Shopping: A Comparative Evaluation" in Michael Lang, et. al., *Tax Treaties: Building Bridges between Law and Economics*, (Amsterdam: IBFD, 2010) 75 at 77, n. 11, suggesting that tax-motivated changes of residence by individuals are "rightly regarded as a form of treaty shopping, but … less likely to be abusive [than tax-motivated changes of residence by artificial entities] given the requirement of a real social and economic presence for individual tax residence."

of residence results in non-taxation or reduced taxation and treaty benefits are indirectly obtained by shareholders who are residents of third jurisdictions.[254] For this reason, the PPT could be expected to apply to transactions such as those in *MIL Investments* in which the taxpayer continued from the Cayman Island to Luxembourg shortly before selling shares the gain from which would otherwise have been subject to tax in Canada,[255] and *Yanko-Weiss Holdings* in which the taxpayer moved its place of effective management from Israel to Belgium before receiving dividends from an Israeli subsidiary.[256]

(B) Other Treaty Abuses

With respect to other treaty abuses, neither the commentary on the OECD model convention nor the Final Report on BEPS Action 6 are as clear on the potential role of the PPT – presumably because BEPS Action 6, the MLI and the 2017 OECD model convention all contain specific anti-abuse rules to address perceived treaty abuses other than tax treaty shopping.[257] Where a CTA does not include these specific anti-abuse rules, however, it is possible that the PPT could apply to tax-motivated transactions or arrangements that either satisfy or circumvent the formal

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[254] For a contrary conclusion, see Kok, *supra* note 93 at 411, arguing that a change of corporate residence should not be subject to the PPT if the relevant treaty includes a tie-breaker rule based on place of effective management. This argument depends on the conclusion that the PPT should not apply to transactions or arrangements that could be subject to a specific anti-avoidance rule if it were included in a tax treaty – in this case, a tie-breaker rule based on the mutual agreement procedure as in article 4(1) of the MLI. This conclusion was rejected earlier in this article at *supra* text accompanying notes 84-100 under the heading "Relevance of Specific Treaty Anti-Abuse Rules not Included in a CTA".

[255] *Supra* note 128, allowing treaty benefits on the grounds that the Canadian GAAR did not apply because it was not established that the transactions were contrary to the object and purpose of the Canada-Luxembourg tax treaty. This case is discussed in the first part of this article.

[256] *Supra* note 129, denying treaty benefits on the basis of an implicit anti-abuse principle. This case is discussed in the first part of this article.

[257] *Supra*, text accompanying notes 35-51 under the heading "Other Treaty Abuses".

requirements of relevant treaty provisions in a way that contradicts their objects and purposes.[258]

As a result, even if a treaty does not include a specific anti-abuse provision like article 14(1) of the MLI to address the tax-motivated splitting-up of contracts to avoid permanent establishment status for a building site or construction or installation project that lasts more than twelve months, the PPT could apply to deny treaty benefits that would otherwise be denied under this rule where granting the benefits would be contrary to the object and purpose of the provision to exclude short-term building or construction or installation projects from source taxation of business profits.[259] Where a construction project that is expected to last 22 months is divided into two different contracts, each lasting 11 months, for example, the commentary concludes that granting the benefit of the exclusion from permanent establishment status under article 5(3) of the OECD model convention "would be contrary to the object and purpose" of this provision "as the time limitation … would otherwise be meaningless."[260]

Since the time limitation in this provision would also be meaningless if separate contracts lasting less than 12 months could always be aggregated to deny the exemption from permanent establishment status, it is clear that this conclusion depends on the facts and circumstances of this example, according to which the bid for the construction project is originally submitted by a company (RCO) resident in

[258] As explained earlier, the relationship between the PPT and specific anti-abuse provisions that are not included in a CTA is ultimately a matter of interpretation having regard to the relevant provisions as well as extrinsic materials such as explanatory memoranda and commentaries that may shed light on the intentions of the contracting jurisdictions. *Supra* text accompanying notes 84-100 under the heading "Relevance of Specific Treaty Anti-Abuse Rules not Included in a CTA".
[259] Paragraph 52 of the commentary on article 5 of the OECD model convention.
[260] Example J in paragraph 182 of the commentary on article 29 of the OECD model convention

State R to an independent company (SCO) resident in State, the contract is then split during negotiations and separate contracts are concluded with RCO and "a recently-incorporated wholly owned subsidiary of RCO" (SUBCO), and "the contractual arrangements are such that RCO is jointly and several liable with SUBCO for the performance of SUBCO's contractual obligations under the SUBCO-SCO contract."[261] Consequently, as with the treaty shopping examples in which the commentary concludes that the PPT would apply, the conclusion that the PPT should apply to this contract-splitting case ultimately depends on the absence of any real economic substance to the arrangement.

Similarly, although the commentary on the OECD model convention does not explicitly state that the PPT can apply to deny benefits that would otherwise be denied under a specific anti-abuse rule for dividend transfer transactions like article 8(1) of the MLI, this conclusion is suggested by the text and context of the MLI and by an example in the commentary that considers the possible application of the PPT to a transaction to which this specific anti-abuse provision could also apply.[262] In this example, a company (RCO) resident in State R that has held 24 percent of the shares of another company (SCO) resident in State S, increases its shareholding to 25 percent following the entry-into-force of a tax treaty between States R and S in order to obtain the reduced rate of withholding tax on dividends under article 10(2)(a) of the OECD model convention.[263] Without discussing the time period between the increase in RCO's shareholding and the receipt of a dividend from SCO, or

[261] *Ibid*.
[262] See the discussion at *supra*, text accompanying notes 88-93.
[263] Example E in paragraph 182 of the commentary on article 29 of the OECD model convention

considering the possible existence of a minimum shareholding period for the reduced withholding tax rate on dividends, the commentary concludes that the PPT "would not apply" deny the benefit of article 10(2)(a) because this provision "uses an arbitrary threshold of 25 per cent for the purposes of determining which shareholders are entitled to the benefit of the lower rate of tax on dividends."[264]

While this statement seems to suggest that the minimum shareholding threshold in article 10(2)(a) operates as a safe harbor, the commentary also states that "granting that benefit in these circumstances would be in accordance with the object and purpose" of the provision because RCO "genuinely increases its participation" in SCO in order to satisfy this requirement.[265] As with the treaty shopping examples in which the commentary concludes that the PPT would not apply, therefore, the conclusion that the PPT would not apply in this circumstance depends on an implicit economic substance criterion that distinguishes genuine cross-border economic activities for which treaty benefits are properly granted from tax-motivated transactions or arrangements with little or no economic substance for which treaty benefits may be denied.

Although the commentary on the OECD model convention does not address the possible application of the PPT to transactions or arrangements that avoid a substituted property rule by diluting the value of shares or comparable interests attributable to immovable property, it is arguable that the PPT could apply in these circumstances even if the CTA does not include a specific anti-abuse provision like article 9(1) of MLI which applies the value threshold for the substituted property

[264] *Ibid*.
[265] *Ibid*.

rule "at any time during the 365 days preceding the alienation".[266] As well, the commentary explicitly states that the PPT could apply to hiring-out of labour arrangements even if a treaty does not include a specific anti-abuse rule to address these arrangements.[267] In each of these cases, application of the PPT would depend on whether the transactions or arrangements contradict the object and purpose of the relevant provisions: to "prevent non-taxation by the source state of capital gains derived principally from immovable property situated in the source state" in the case of the substituted property rule,[268] and "to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the State of source" in the case of article 15(2) of the OECD model convention.[269] As with the application of the PPT to other transactions or arrangements, the presence or absence of real economic substance may well be relevant to this inquiry.

(c) Effect of Object and Purpose Test as an Exception

In the guiding principle and the Canadian GAAR, the object and purpose test constitutes an additional requirement that must be satisfied in order to deny benefits that would otherwise be available, imposing an onus on the revenue department to establish that a benefit that a taxpayer would otherwise obtain is contrary to the object and purpose of the relevant provisions. In this context, therefore, the object and purpose test requires the revenue department to "go behind" the ordinary meaning of the relevant provisions in order to demonstrate

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[266] See the discussion at *supra*, text accompanying notes 98-100.
[267] Paragraph 8.8 of the commentary on article 15 of the OECD model Convention.
[268] *Alta Energy*, *supra* note 217 at para 41.
[269] Paragraph 6.2 of the commentary on article 15 of the OECD model convention.

why a benefit that would otherwise result from the ordinary meaning of these provisions should be denied on the grounds that granting the benefit would contradict their objects and purposes.[270] For this reason, Canadian courts have generally held that the GAAR should apply only where the object and purpose of the relevant provisions is "clear and unambiguous".[271]

In the PPT, on the other hand, the object and purpose test is an exception that allows a benefit that would otherwise be denied under the provision on the grounds that one of the principal purposes of a transaction or arrangement was to obtain the benefit. As a result, the PPT shifts the onus to the taxpayer to establish that a benefit that would otherwise be denied should be allowed because it is in accordance with the object and purpose of the relevant provisions of a CTA. For this reason, the PPT has been sharply criticized.[272]

Since the PPT applies only to benefits that would otherwise be granted under the ordinary meaning of the relevant provisions, however, this onus should be easier to establish than the onus on the revenue department under the guiding principle

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[270] See, e.g., *Copthorne*, *supra* note 107 at para. 66, stating that the Canadian GAAR is "a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer".

[271] See, e.g., *OSFC*, *supra* note 189 at para. 69; *Canada Trustco*, *supra* note 70 at para. 50; and *Copthorne*, *supra* note 107 at para. 68. This conclusion is consistent with the language of subsection 245(4) as it read at the time of the decision in *OSFC* which provided that the GAAR would not apply to an avoidance transaction where it was reasonable to conclude that the transaction did not result in a misuse or abuse, but is not consistent with the amended language of this provision which provides that the GAAR applies to an avoidance transaction if it may reasonably be considered to result in a misuse or abuse. See David G. Duff, "The Supreme Court of Canada and the General Anti-Avoidance Rule" (2006), 60 *Bulletin for International Taxation* 54 at 67. Without specifically addressing this issue, a majority of the Supreme Court of Canada stated in *Lipson*, *supra* note 75 at para. 21, that the Canadian GAAR imposes a burden on the revenue department "to prove, *on the balance of probabilities*, that the avoidance transaction results in abuse and misuse within the meaning of s. 245(4)" [emphasis added].

[272] See, e.g., De Broe and Luts, *supra* note 65 at 145, arguing that the burden of proof in the PPT is "manifestly unbalanced."

and the Canadian GAAR, since it requires taxpayers only to demonstrate that the objects and purposes of the relevant provisions are consistent with their ordinary meaning, not incompatible with their ordinary meaning. As a result, even though the PPT imposes a "reversed" onus on the taxpayer to establish that the granting of a benefit is in accordance with the object and purpose of the relevant provisions, the ultimate effect may not be very different from the guiding principle or the Canadian GAAR, since it is reasonable to expect that the revenue department will still be required to go behind the words of the relevant provisions to demonstrate why granting the benefit under a CTA would be contrary to the object and purpose of the relevant provisions.[273]

At the same time, since the object and purpose exception in the PPT applies where "it is established" that granting a benefit would be in accordance with the object and purpose of the relevant provisions, not where it is "reasonable to conclude" or "clearly established" that granting a benefit would be in accordance with the object and purpose of the relevant provisions, the applicable standard appears to be on the balance of probabilities so that neither the taxpayer nor the revenue department must "clearly and unambiguously" establish that granting a benefit is either consistent with or contrary to the object and purpose of the relevant provisions.[274] In this respect, as with the purpose test, the PPT imposes a lower burden on the revenue department than the guiding principle or the Canadian GAAR.

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[273] For a similar conclusion, see Lang, *supra* note 82 at 660, arguing that "[t]he fact that this criterion was formulated as an exception is irrelevant."

[274] Chand takes a contrary view, relying on the Supreme Court of Canada decision in *Canada Trustco*, *supra* note 70 at para 50, for the proposition that "the benefit of the doubt … shall go to the taxpayer." Chand, *supra* note 178 at 21. Notwithstanding the conclusion in *Canada Trustco* (which, as noted at

(4) Consequences of Application

Where a transaction or arrangement results directly or indirectly in a benefit under a CTA, it is reasonable to conclude that one of the principal purposes of the transaction or arrangement is to obtain the benefit, and it is not established that granting the benefit is in accordance with the object and purpose of the relevant provisions of the CTA, the PPT provides that the benefit "shall not be granted". In this respect, the consequences of the PPT's application are similar to those of the guiding principle, which states that "the benefits of a double taxation convention should not be available" where the principle applies.

Where the Canadian GAAR applies, on the other hand, the provision states that "the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit" that would otherwise result from the transaction or series of transactions.[275] As a result, unlike the PPT and the guiding principle, the Canadian GAAR establishes an objective "reasonable in the circumstances" standard for determining the tax consequences of its application, and limits these tax consequences to those that are reasonable "in order to deny [the] tax benefit".[276] Since the characterization of a tax benefit under the Canadian GAAR generally depends on a comparison with the tax consequences resulting from an alternative transaction or arrangement that "might reasonably have been carried out but for the existence of the tax benefit,"[277] moreover, the tax consequences that are

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supra note 271, is itself inconsistent with the amended text of subsection 245(4) of the ITA), this approach is not consistent with the text of the PPT.

[275] ITA, s. 245(2).

[276] Arnold and Wilson, *supra* note 142 at 1171-1172.

[277] *Copthorne Holdings*, *supra* note 107 at para. 35, citing Duff, et. al, *Canadian Income Tax Law*, *supra* note 107 at 187.

"reasonable in the circumstances in order to deny a tax benefit" generally correspond to those that would have resulted under the alternative transaction or arrangement. For this reason, the Canadian GAAR contains an implicit recharacterization principle governing the tax consequences of its application.

In contrast, because the PPT states only that a benefit under a CTA "shall not be granted" when the provision applies, the application of this provision could make taxpayers worse off than they would have been under an alternative transaction or arrangement that might reasonably have been carried out but for the existence of the treaty benefit that is denied. For example, where an individual assigns the right to receive dividends that have been declared but not paid to a company owning more than the minimum shareholding that is required for the lower rate of withholding tax on dividends payments from a subsidiary to a parent, the PPT could deny the benefit of *any* withholding tax reduction under the CTA rather than the benefit of the lower withholding tax rate. Likewise, where a taxpayer resident in one state assigns the right to receive dividends, interest or royalties to a company resident in a state that has a more advantageous tax treaty with the source state than the state of which the taxpayer is a resident, the PPT could also apply to deny the benefit of any withholding tax reduction, rather than the benefit of the reduced withholding tax under the more advantageous tax treaty.

Although the PPT could recognize treaty benefits that would have been obtained under an alternative transaction or arrangement if the meaning of "a benefit under a Covered Tax Agreement" were understood by reference to the tax consequences that would have resulted from this alternative transaction or arrangement, this interpretation is less persuasive than the more obvious interpretation of this term which compares the tax consequences of the transaction or arrangement to the tax consequences that would have resulted under the domestic law of a contracting jurisdiction absent the CTA.[278] Nor does the PPT itself authorize the recharacterization of a transaction or arrangement in order to recognize alternative treaty benefits, though more than one commentator have correctly observed that the PPT would not apply to a suitably recharacterized transaction or arrangement if such recharacterization were available under domestic law.[279]

Instead, the MLI contains a remedial benefits rule authorizing the competent authority of the contracting jurisdiction that would have granted a treaty benefit but for the PPT to:

> … nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement.[280]

Of eighty-four jurisdictions that had signed the MLI as of 18 September 2018, however, only twenty-eight (not including Canada) had adopted this provision.[281]

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[278] See the discussion at *supra* text accompanying notes 106-110.

[279] See, e.g., Danon, *supra* note 69 at 51, arguing the PPT would not apply where "treaty benefits are granted on a recharacterized fact pattern"; and Chand, *supra* note 178 at 40, concluding that alternative treaty benefits may be granted "if such benefits are available under domestic law mechanisms."

[280] Article 7(4) of the MLI. In this circumstance, the provision continues: "The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before rejecting the request."

[281] Figures compiled by the author from positions of signatories available at OECD, "Signatories and Parties to the Multilateral Convention To Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting: Status as of 18 September 2018" *supra* note 33.

As the commentary on the OECD model convention explains, this provision is intended to allow the competent authority of a Contracting State to "have the possibility" of treating a person who is denied a benefit under the PPT "as being entitled to this benefit, or to different benefits with respect to the relevant item of income or capital, if such benefits would have been granted to that person in the absence of the transaction or arrangement" that triggered application of the PPT.[282] For example, the commentary explains, where an individual who is resident in State R and owns shares of SCo, which is resident in State S, assigns the right to receive dividends declared by SCo to another company resident in State R which owns more than 10 percent of the capital of the paying company for the principal purpose of obtaining a reduced rate of withholding tax under article 10(2)(a) of the treaty, and the PPT applies, this provision would:

> … allow the competent authority of State S to grant the benefit of the reduced rate provided for in subparagraph b) of paragraph 2 of Article 10 if that competent authority determined that such benefit would have been granted in the absence of the assignment to another company of the right to receive dividends.[283]

Although this provision allows for the possibility of remedial benefits, it is poorly drafted since it limits these benefits to those that would have been granted to the same person ("that person") in the absence of the transaction or arrangement. As the above example indicates, however, the alternative treaty benefits might have been granted to a different person than the person whose treaty benefits are denied

[282] Paragraph 184 of the commentary on article 29 of the OECD model convention. See also *ibid*. at paragraph 185, emphasizing that the provision grants broad discretion to the competent authority to which the request is made to determine whether a benefit would have been granted in the absence of an arrangement or transaction subject to the PPT, but also noting that the provision requires the competent authority to consider all the relevant facts and circumstances before reaching a decision and requires the competent authority to consult with the competent authority of the other Contracting State before rejecting a request brought by a resident of the other Contracting State.
[283] Paragraph 186 of the commentary on article 29 of the OECD model convention.

under the PPT. For this reason, it would have been preferable to provide for alternative benefits to be granted if the competent authority determines that such benefits "would have been granted in the absence of the transaction or arrangement" regardless of the person to whom they would have been granted.[284]

More generally, this provision is also deficient because it leaves the decision to grant alternative benefits to the discretion of the competent authority of the contracting jurisdiction that would have granted a treaty benefit but for the PPT, subject only to the requirement that it consult the competent authority of the other contracting jurisdiction before rejecting a request for such benefits. Instead, as at least one commentator has suggested, the right to alternative benefits should be automatic,[285] and any penalty associated with application of the PPT should be levied explicitly rather than implicitly through the denial of other treaty benefits that would otherwise have been available.

Finally, it is unfortunate that neither the MLI nor the OECD model convention nor the commentary on the OECD model convention address the consequences in the other contracting jurisdiction where one contracting jurisdiction applies the PPT to deny benefits that would otherwise have been available under the CTA.[286] Since the elimination of double taxation article in a CTA obliges the state of residence to allow a credit for income tax paid in the source state where this income is taxed "in accordance with the provisions" of the CTA, the denial of treaty benefits by the source state should create a corresponding obligation on the residence state to

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[284] Danon, *supra* note 69 at 52.
[285] *Ibid*.
[286] For a useful discussion of possible challenges, see Lang, *supra* note 82 at 662-663.

credit the increased tax that must be paid in the source state. The extent of this obligation, however, will presumably depend on whether the source state applies the PPT to deny all treaty benefits or grants treaty benefits that would have been granted in the absence of the transaction or arrangement. Where the contracting jurisdictions disagree about application of the PPT or the appropriate consequences, double taxation is likely and resort to the mutual agreement procedure may be the only alternative.[287]

Conclusion

Although based on the OECD's guiding principle and similar in structure to many domestic GAARs including the Canadian GAAR, the PPT represents a significant development in international tax law, adding a general anti-abuse provision to all CTAs as well as other tax treaties that follow the 2017 OECD model convention. As with the introduction of domestic GAARs, the PPT will pose new challenges for tax practitioners, revenue authorities and adjudicators, since treaty benefits that would previously have resulted from tax-motivated transactions or arrangements may now be denied under the PPT. These challenges may be compounded to the extent that the PPT will apply to multiple tax treaties among many jurisdictions, which may not adopt similar approaches to tax treaty interpretation generally or the PPT in particular.[288] As a result, over the short run at

[287] Taboada, *supra* note 142 at 606.

[288] For a pessimistic assessment, see Philip Baker, "The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" [2017] *Brit. Tax Rev.* 281 at 283, concluding that: "There is every reason to fear that, once the MLI is in force and a large number of countries (including ones with tax authorities that do not have a reputation for predictable interpretation of tax treaties) begin to apply the PPT, this will undermine the whole system of tax treaty benefits."

least, the PPT can be expected to increase uncertainty in international tax planning and lead to an increased number of tax treaty disputes[289] – a result that the OECD itself anticipates in also seeking to make dispute resolution mechanisms more effective through BEPS Action 14.[290]

At the same time, it is important to recognize that pre-BEPS responses to tax treaty shopping and other perceived tax treaty abuses have themselves been varied and inconsistently applied, and that the PPT is intended not only to intended to both strengthen treaty-based responses to perceived tax treaty abuses but also to promote greater consistency in these responses through a single anti-abuse provision which all signatories to the MLI have chosen to adopt in order to satisfy the OECD's minimum standards on tax treaty abuse under BEPS Action 6. If this objective of increased consistency is to be realized, however, it is important that tax practitioners, revenue authorities and adjudicators understand why the PPT was adopted, how it relates to other anti-avoidance doctrines, principles and rules, the requirements for and consequences of its application, and the kinds of transactions or arrangements to which it may reasonably be expected to apply. It is to this end that this article is directed.

Briefly recapping, the first part of this article surveyed pre-BEPS responses to tax treaty shopping and other perceived tax treaty abuses, providing necessary background and context for understanding BEPS Action 4, the MLI, the PPT, and the kinds of transactions or arrangements to which the PPT can be expected to apply.

[289] See, e.g., Danon, *supra* note 69 at 32; and Kuźniacki, *supra* note 120 at 32.
[290] OECD, *Making Dispute Resolution Mechanisms More Effective*, BEPS Action 14: 2015 Final Report, (Paris: OECD, 2015).

Building on this analysis, the second part of the article has examined the PPT in the context of BEPS Action 4 and other provisions of the MLI, considering the relationship between this general anti-abuse provision and other anti-avoidance doctrines, principles and rules, and the various elements that comprise its basic structure including the various tests that must be satisfied for the provision to apply as well as the consequences of its application.

With respect to other anti-avoidance doctrines, principles and rules, it seems reasonable to conclude that the PPT will, where applicable, displace the "guiding principle" in the commentary on the OECD model convention,[291] but not domestic anti-avoidance doctrines and statutory anti-avoidance rules, which should be considered prior to the PPT since these doctrines and rules generally determine the characterization of transactions or arrangements to which tax treaty apply.[292] In this respect, as with treaty-based SAARs, the PPT is properly regarded as a provision of "last resort" that should not be used to augment the tax consequences resulting from the application of other anti-avoidance doctrines or rules.[293] Where a treaty-based SAAR does not apply to a transaction or arrangement, on the other hand, the PPT may apply if the transaction or arrangement circumvents the SAAR in a manner that contradicts its underlying object and purpose.[294] Likewise, it appears as though the PPT may also apply to transactions or arrangements that would otherwise be subject

[291] *Supra* text accompanying notes 66-69 under the heading "Relationship to Implicit Anti-Abuse Principle".
[292] *Supra* text accompanying notes 57-65 under the heading "Relationship to Domestic Anti-Avoidance Doctrines and Statutory Anti-Avoidance Rules".
[293] *Supra* text accompanying notes 70-75 under the heading "Relationship to Specific Treaty Anti-Abuse Rules in a CTA".
[294] *Supra* text accompanying notes 76-83 under the heading "Relationship to Specific Treaty Anti-Abuse Rules in a CTA".

to treaty-based SAARs that do not modify a particular CTA or are not otherwise included in the CTA.[295]

Regarding the structure of the PPT itself, application of this provision turns on the satisfaction of three tests: (1) a result test, which requires that a transaction or arrangement has resulted directly or indirectly in a benefit under a CTA; (2) a purpose test that applies where it is reasonable to conclude, having regard to all the relevant facts and circumstances, that obtaining the benefit was one of the principal purposes of the transaction or arrangement; and (3) an object and purpose test that excludes transactions or arrangements from application of the PPT where it is established that granting the benefit would be in accordance with the object and purpose of the relevant provisions of the CTA. Where the first two tests are satisfied and the third is not, the PPT denies the benefit that would otherwise be granted under the CTA.

The result test requires a connection or nexus between the transaction or arrangement and the benefit, which may be easily established where a single transaction results in a benefit, but could be more difficult to identify where a benefit results indirectly from another transaction or arrangement or from several transactions that may or may not comprise an arrangement for the purposes of the PPT. However, since the concept of an arrangement may be broadly understood to include an extended series of transactions, and the PPT clearly applies where benefits are obtained indirectly as well as directly, this test is likely to be easily

[295] *Supra* text accompanying notes 84-100 under the heading "Relationship to Specific Treaty Anti-Abuse Rules not Included in a CTA".

satisfied.[296] Unlike the Canadian GAAR, for which the concept of a tax benefit may be interpreted by reference to a benchmark transaction that might reasonably have been carried out but for the existence of the tax benefit, the most reasonable interpretation of a benefit under a CTA relates to the tax consequences that would have resulted under the domestic law of the relevant contracting jurisdiction absent the CTA.[297]

The purpose test requires an objective assessment of the principal purposes of the transaction or arrangement in order to determine whether one of these purposes was to obtain a benefit under a CTA.[298] Interpreting similar language in the context of domestic tax provisions, U.K. decisions have held that a principal purpose "has a connotation of importance"[299] and that a principal purpose of a transaction may be to obtain a tax advantage even if the transaction had a commercial objective at least as important as the tax advantage.[300] As a result, the threshold for this purpose test is lower than the threshold in most domestic GAARs which generally apply only where the sole or dominant purpose of a transaction or arrangement is to obtain a tax benefit, and lower than the threshold in the Canadian GAAR which applies where a transaction or arrangement is undertaken primarily to obtain a tax benefit.[301] Since the purposes test applies where it is "reasonable to conclude" that one of the principal purposes of a transaction or arrangement is to obtain a benefit, it

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[296] *Supra* text accompanying notes 117-134 under the headings "Transaction or Arrangement" and "Benefit Results Directly or Indirectly from the Transaction or Arrangement".
[297] *Supra* text accompanying notes 101-116 under the heading "Benefit under a CTA".
[298] *Supra* text accompanying notes 139-152 under the heading "Purpose of a Transaction or Arrangement" and notes 187-193 under the heading "Reasonableness of Conclusion".
[299] *Travel Document Service*, *supra* note 167 at para. 48.
[300] *Lloyds TSB Equipment Leasing* (TCC), *supra* note 168 at para. 82.
[301] *Supra* text accompanying notes 153-181 under the heading "One of the Principal Purposes of a Transaction or Arrangement".

also imposes a relatively low burden on the revenue authority, effectively requiring taxpayers to argue that it would be unreasonable to conclude that a principal purpose of a transaction or arrangement was to obtain a benefit under a CTA.[302] As a result, the purpose test in the PPT may also be easy to satisfy, as a result of which application of the provision will turn primarily on whether granting the benefit would be in accordance with the object and purpose of the relevant provisions of the CTA.[303]

The object and purpose test requires an assessment of the "relevant provisions" of the CTA as well as their underlying objects and purposes, in order to determine whether granting a treaty benefit in the circumstances would be in accordance with these objects and purposes. In addition to the specific provision that is relied upon to obtain the benefit, relevant provisions include other provisions that are circumvented by the transaction or arrangement, as well as provisions of the CTA (including the preamble) read as a whole – which reflect the objects and purposes of the CTA more generally.[304] Since contracting jurisdictions to the MLI are required to adopt the amended preamble language in article 6(1) in order to implement the minimum standard on BEPS Action 6, this amended preamble language will be particularly relevant to cases of tax treaty shopping.[305] Other relevant provisions may include provisions of the MLI of model treaties that are not included in the particular CTA – though the relevance of these provisions will presumably depend on extrinsic evidence of whether the parties intended to permit

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[302] *Supra* text accompanying notes 194-195 under the heading "Reasonableness of Conclusion".
[303] *Supra* text accompanying note 196 under the heading "Reasonableness of Conclusion".
[304] *Supra* text accompanying notes 201-208 under the heading "Relevant Provisions".
[305] *Supra* text accompanying note 205 under the heading "Relevant Provisions".

transactions or arrangements that might otherwise be prohibited by these provisions or intended to rely on the more general language of the PPT to challenge these transactions or arrangements without adopting the detailed limitation of these SAARs.[306]

Unlike ordinary interpretation, in which the object and purpose of a provision is relied upon in order to interpret its ordinary meaning, the object and purpose test in the PPT looks to the rationale that underlies the words of the provision or the treaty as a whole, which may not be fully expressed by the words themselves.[307] Although these objects and purposes may be inferred from the text of the relevant provision, they may also be explained in extrinsic materials like the commentary on the OECD model convention, or construed in light of the more general objects and purposes of the CTA as a whole.[308] Once the objects and purposes of the relevant provisions are determined, a second stage of the object and purpose analysis involves a factual assessment of the transaction or arrangement at issue to determine whether granting a benefit is in accordance with these objects and purposes.[309] Statements and examples in the commentary on the OECD model convention suggest that this will generally be the case for transactions or arrangements involving genuine cross-border economic activities, but not for transactions or arrangements with little or no real economic substance.[310]

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[306] *Supra* text accompanying notes 209-211 under the heading "Relevant Provisions".
[307] *Supra* text accompanying note 213 under the heading "Treaty Benefit in Accordance with Object and Purpose of Relevant Provisions".
[308] *Supra* text accompanying notes 215-225 under the heading "Interpreting the Object and Purpose of a Treaty Provision".
[309] *Supra* note 212 and accompanying text.
[310] *Supra* text accompanying notes 182-1867 under the heading "One of the Principal Purposes of a Transaction or Arrangement" and notes 226-268 under the heading "Assessing the Facts".

In contrast to the object and purpose tests in the guiding principle and the Canadian GAAR, which operate as additional requirements that must be satisfied in order to deny benefits that would otherwise be available under an ordinary interpretation of the relevant provisions, the object and purpose test in the PPT is an exception to the general anti-abuse provision that allows benefits that would otherwise be denied where it is established that granting the benefit would be in accordance with the object and purpose of the relevant provisions. Although this shifts the onus from the revenue authorities to the taxpayer, the ultimate effect may be negligible since the guiding principle and the Canadian GAAR require the revenue authorities to go behind the words of the relevant provisions to demonstrate that granting a benefit would be contrary to the objects and purposes of these provisions, while the PPT requires taxpayers to argue only that granting a benefit that would otherwise be available under the ordinary interpretation of the relevant provisions is also consistent with their underlying objects and purposes – which shifts the onus back to the revenue authorities to establish that granting the benefit would be contrary to the objects and purposes of these provisions.[311]

Finally, since the PPT states only that a benefit under a CTA "shall not be granted" if the provision applies, it seems likely that the provision could have punitive consequences – denying not only a treaty benefit that would have resulted from the transaction or arrangement at issue but also other treaty benefits that would have resulted under an alternative transaction or arrangement that might

[311] *Supra* text accompanying note 272 under the heading "Effect of Object and Purpose Test as an Exception".

otherwise have been carried out.[312] Although the MLI includes a provision authorizing the competent authority of the contracting jurisdiction that would have granted treaty benefits but for the PPT to grant remedial benefits to a person if it determines that these benefits would have been granted to that person in the absence of the transaction or arrangement at issue, this provision is deficient since it limits these benefits to those that would have been granted to the same person in the absence of the transaction or arrangement, depends discretion of the competent authority of the contracting jurisdiction that would otherwise have granted the benefit, and does not address the obligations of a residence states to make adjustments consequential on application of the PPT by a source state.[313] Aside from these deficiencies, it is unfortunate that of eight-four signatories to the MLI as of 18 September 2018 only twenty-eight (not including Canada) indicated that they would adopt this remedial benefits provision.[314] Although this may suggest that contracting jurisdictions intend that the PPT should have punitive consequences, it may also be the case that contracting jurisdictions have not fully considered the potential consequences of the PPT's application. Indeed, if these punitive consequences make revenue authorities and adjudicators reluctant to apply the PPT in the first place, failure to adopt the remedial benefits provision may undermine the potential role of the PPT.

[312] *Supra* text accompanying notes 273-277 under the heading "Consequences of Application".
[313] *Supra* text accompanying notes 278-285 under the heading "Consequences of Application"
[314] Figures compiled by the author from positions of signatories available at OECD, "Signatories and Parties to the Multilateral Convention To Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting: Status as of 18 September 2018" *supra* note 33.