If the Shoe Fits:

Why Shopping for the Best Tax Treaty is not Always a Cinderella Story.

By: Aaron Grinhaus

January 4, 2013

Table of Contents

I. A Cinderella Story

Tax planning is no fairy tale. First, the starting point is often disorganized as rarely are clients prepared for a reorganization or a restructure of any substantial magnitude. Second, clients generally do not anticipate the consequences until it is too late; the epiphanic moment usually occurs when the tax bill arrives and the client's retained earnings are reduced from a carriage to a pumpkin. By the time the client does get to a tax planner, midnight has struck and the damage has been done. The client has expended considerable effort in its back breaking labour only to find that the fruits of its labour have been co-opted by an unsympathetic step-relative of the government: the tax authority. The tax planner must then create a plan of action which will stop the flow of tax dollars from the client to the government coffers.

When the tax planner finds that the client is receiving no love at home for all the work it has done, he or she must explore options in far-away lands. The tax planner has many tools at its disposal to help mitigate its client's tax burden, and may use those tools in any combination of ways to assist its client in arranging its affairs in the most tax efficient manner.[1] Among those tools is the movement of operations to a more tax-friendly jurisdiction in order to reduce the basic tax rate as a starting point for reducing the client's overall tax liability. This can be a complex and arduous task requiring the consideration of many factors.

Choosing an offshore jurisdiction is no Cinderella story. On the surface it may seem that looking for the best tax rate would be the chief motivating factor; however, there is much more to it than that. Governmental and economic conditions, proximity, and domestic legal rules, *Inter alia*, all play a role in a tax planner's decision to move offshore. But perhaps the most prevalent consideration is whether, and on what terms, the offshore jurisdiction has a treaty with the home jurisdiction in which the client is resident at the time the structure is contrived. While treaty

[1] *Commissioners of Inland Revenue v. Duke of Westminster,* [1936] A.C. 1 (H.L.) (the "**Westminster Principle**").

jurisdictions do not necessarily possess the lowest tax rates, they do provide a degree of certainty with respect to the systems and processes required to administer, pay and avoid double taxation between jurisdictions. The practice of searching for the most palatable jurisdiction has taken on the pejorative moniker of "treaty shopping", which has been defined as follows:

> The term "treaty shopping" refers to the situation where a person, who is resident in a given country (the home country) and who derives income or capital gains from another country (the source country), is able to gain access to a tax treaty in place between the source country and a third country that offers a more generous tax treatment than the tax treatment otherwise applicable. This situation could arise if the person is resident in a country that does not have a tax treaty with the source country, or if the tax treaty between the source country and the person's home country offers less generous tax treatment than the tax treaty between the source country and the third country.[2]

On the one hand, its derogatory connotation may be the result of the activity being motivated by the desire to avoid paying tax; on the other, it may be because choosing a jurisdiction is not as simple as waving a wand. It requires an analysis well beyond whether one prefers beaches to mountains.

The purpose of this paper is to compare four regions with which Canada has treaties: the United States (as a region of itself), East Asia, the Caribbean, and Europe. The comparison will reveal the strengths and weaknesses of each, the key differences among the treaties and the considerations required when choosing the most appropriate among them for an offshore structure. After analyzing the doctrinal differences and other factors impacting the treaties, the paper will summarize the differences and act as a practical guide to allow the tax planner to determine on which foot the glass slipper fits best.

[2] Advisory Panel on Canada's International Tax System, "Enhancing Canada's International Tax Advantage: A Consultation Paper Issued by the Advisory Panel on Canada's System of International Taxation" (Ottawa: APCSIT, April 2008) at para. 3.18.

The paper will begin by providing the background in Canadian tax and treaty policy, including the domestic policies and the bases cases which govern Canadian tax treaty application. The author will continue by discussing the general legislative landscape within the above mentioned regions with respect to their tax treaties with Canada. The domestic laws within these regions have an impact on the treaties and how they operate with respect to Canada. The author will then survey the academic discourse on the subject and reveal the high-level concerns with respect to the respective regions and will note the critical differences in tax treaty policies between the regions. Finally, the author will break down the key differences and considerations required when choosing a treaty from one of the above mentioned regions in order to provide a starting point for tax planners. The object of this paper is to demonstrate that key treaty provisions combined with domestic legislation, and not necessarily the tax rate itself, are the leading factors in the determination of the best treaty jurisdiction for a given tax structure.

When it comes to tax treaties, one size does not fit all.

II. Invitation to the Ball

Finding plain English information about the operation of Canadian tax treaties is not as easy as waving a magic wand. Unlike most Canada Revenue Agency ("**CRA**") procedures, there is no readily available handbook or guideline available for use by the taxpayer. The website provided by the CRA on this topic is among the most barren of sites with little practical information, leaving much to be desired. The site explains that "[a] tax treaty is designed to avoid double taxation for people who would otherwise pay tax on the same income in two countries. Generally, a tax treaty determines how much each country can tax income such as: pensions; wages; salaries; interest".[3] It is clearly designed to address a very limited scope of

[3] "Tax Treaties" *Canada Revenue Agency* (2012), online: CRA < http://www.cra-arc.gc.ca/tx/nnrsdnts/trty-eng.html >.

treaty applicability, and not designed to address the concerns of businesses. It does, however, direct the reader to a list of treaties and competent authority related information, which could be useful, provided the reader knows what "competent authority" means.

It is therefore incumbent on the inquisitor to source the relevant considerations from alternate sources. A Canadian businessperson with off shore interests must first look to the domestic rules respecting interpretation in order to avoid running afoul the Canadian tax regime. One example is using a "hybrid arrangement" to reduce a company's tax liability, where the characterization of such arrangement (such as distinguishing a debt instrument from an equity instrument) is difficult to ascertain. One commentator notes that:

> Hybrid arrangements involving cross-border instruments, entities, and transfers have been used by taxpayers to lower their effective cross-border tax burden mainly in the last decade or so. ... The tax authorities have dealt with the uncertainty regarding the classification of instruments or entities with hybrid characteristics by referring to a list of features that are typical for any given entity or instrument, and by considering the intention of the parties. For Canadian tax purposes, the ultimate classification of the entity or instrument under the laws of a foreign country is not determinative.[4]

In this example the domestic law will take precedence over the international agreement in order to clarify how the instrument will be characterized for the purposes of the treaty. Tax planners must start with the rules of their home jurisdiction before attempting to interpret the rules of any off shore jurisdictions.

In addition, tax planners should be cognizant of the CRA's antagonism towards cross-border tax avoidance transactions, particularly in recent years. It has been noted that:

[4] Mária Tatarová, "Hybrid Mismatch Arrangements: The OECD Report and the Canadian Perspective" (2012) 3 CTJ 701 at 705.

> [t]he Canadian tax authorities have a history of challenging international tax transactions. Although there have been significant modifications to the legislation dealing with these types of transactions (as reflected in the legislation and changes noted above), the CRA has increased its focus on challenging these types of arrangements by using a myriad of 'anti-avoidance' provisions, as opposed to challenging the interpretation of the specific provisions that were relied upon.[5]

An empirical example of this behaviour is demonstrated in *MIL Investments*.[6]

In *MIL Investments* the CRA applied the General Anti-Avoidance Rule ("**GAAR**") found in section 245 of the Income Tax Act (the "**Act**")[7] in the context of a tax treaty.[8] MIL (Investments) S.A. (the "**Corporation**") was originally incorporated under the laws of the Cayman Islands and held an interest in a Canadian resident corporation. The shareholders continued the Corporation in Luxembourg in order to take advantage of its preferential treatment of capital gains and subsequently disposed of its shares in the Canadian corporation.[9] In applying article 13(5) of the treaty between Luxembourg and Canada (as it was at the time), the transaction was taxed only in Luxembourg.[10]

The CRA subsequently assessed the transaction as an avoidance transaction under the GAAR. The assessment was appealed and the Tax Court of Canada ("**TCC**") ultimately decided in favour of the taxpayer, holding, *inter alia*, that:

> There is nothing inherently proper or improper with selecting one foreign regime over another. Respondent's counsel was correct in arguing that the selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the use of the selected treaty that must be examined.[11]

[5] Tony J. Ancimer, "International Tax Update for Non-Specialists" (2007) Ontario Tax Conference, (Toronto: Canadian Tax Foundation) 2:1-32 at 7.
[6] *MIL (Investments) S.A. v. Canada*, 2006 TCC 460.
[7] *Income Tax Act*, R.S.C. 1985, (5th Supp) c.1, s. 245.
[8] 2006 TCC 460.
[9] *Ibid*. at paras. 17-19.
[10] *Ibid*. at para. 73.
[11] *Ibid*. at para. 72.

In other words, the Westminster Principle applies to international tax structuring, and choosing a low-tax jurisdiction is not wrong in and of itself.

Two important points can be drawn from this case: first, that "the Canadian tax authorities are willing to apply the GAAR to transactions that they consider to be taking advantage of the provisions of a tax treaty", but as a backstop "the courts may not be very receptive to this approach unless there is an indication in the treaty that the two countries intended the benefits of the treaty to be limited."[12]

An example of such a treaty limitation can be found in the Limitation on Benefits provisions of the Canada-USA tax treaty[13]; however, even with legislative supremacy backing the treaty, it's broad language will undoubtedly leave it open to challenge in the domestic political and judicial arenas. It should be noted that "the scope of [the Limitation on Benefits] coverage is disproportionate to the abuse it purports to prevent. ... An overly broad treaty anti-avoidance rule inappropriately burdens taxpayers with high compliance and administrative costs and is an undue impediment to normal commerce between the two countries."[14] The treaty's cost of compliance, however, is arguably money well spent in the shadow of the "Revenue Rule".

The "Revenue Rule" is the rule which asserts the tax enforcement sovereignty of states. This rule has been crystallized in Canadian jurisprudence, though in recent years it has begun to yield under the weight of globalization in the form of increasing international electronic business transactions.[15] The "Revenue Rule" is a fail-safe where a treaty does not exist, or where one

[12] Tony J. Ancimer, "International Tax Update for Non-Specialists" (2007) Ontario Tax Conference, (Toronto: Canadian Tax Foundation) 2:1-32 at 8.
[13] *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital*, September 26, 1980, S.C. 1984, c.20, Part I, Article XXIX A.
[14] Marc Darmo and Angelo Nikolakakis, "The New Rules on Limitation on Benefits and Fiscally Transparent Entities" Report of Proceedings of Sixty-First Tax Conference, 2009 Tax Conference (Toronto: Canadian Tax Foundation, 2010) 26:1 at 26:4.
[15] David Bishop Debenham "From the Revenue Rule to the Rule of the 'Revenuer': A Tale of Two Davids and Two Goliaths" (2008) 56 CTJ 1-66.

provides for consensual enforcement, as do many of Canada's tax treaties. It has been stated that "while the reluctance of foreign courts to enforce extraterritorial tax claims provided an additional level of safety for cross-border tax-avoidance schemes...[t]he [] loss of tax revenues has raised questions about the rationale for preserving the revenue rule in the 21st century, when tariff protectionism has been largely abandoned as a viable policy for the conduct of international commerce."[16] The "Revenue Rule" is therefore another domestic aspect of enforcement of which the off shore tax planner must be aware.

Finally, similar to the application of certain domestic canons and rules, interpretation is a variable which forms another caveat for tax planners. One such example is the definition of the term "beneficial owner", which is generally used in the tax treaties to which Canada is a signatory. The way in which the term is defined by the parties domestically will determine its practical application if and when a dispute arises between the jurisdictions. This creates uncertainty for the tax planner and tensions between the parties to the treaty. The cases and commentary thereon have sought to clarify the law of the land so that anyone trying on the shoe knows what's in store if it fits.

III. The Royal Decree

The courts have struggled to keep pace with, and properly interpret, the international agreements governing tax related matters. As was mentioned above, interpreting widely used terms such as "beneficial owner" is only valuable until it reaches the dotted line on the map indicating sovereign jurisdiction, at which point it becomes inapplicable. The "beneficial owner" provisions, which limit treaty benefits if the recipient of payments (such as interest and

[16] *Ibid*. at 5.

dividends) is in fact a resident of the other contracting state, are inserted, *inter alia*, for the purpose of curbing treaty shopping.[17]

The leading case on the definition of "beneficial owner" with respect to the model tax convention created by the Organization for Economic Cooperation and Development (the "**OECD Model Treaty**")[18] as it applies in the Canadian context is *Prévost Car*.[19] In *Prévost Car*, the Federal Court of Appeal ("**FCA**") heard an appeal from a decision of the TCC.[20] The lower court held that, where Canada has a tax treaty with one country which allows its resident corporations to issue dividends to corporate shareholders in that country at a reduced withholding rate, and the receiving corporation subsequently issues dividends to additional shareholders in other countries that do not have such preferential withholding rates, that the beneficial owner is in fact the resident of the first country in the chain and the preferential treaty rates apply.[21]

At the appellate level the Crown argued that "the Judge gave to the term[s] 'beneficial owner' the meaning they have in common law, thereby ignoring the meaning they have in civil law and in international law", leading the court to immediately and explicitly recognize that "[i]t is common ground that there is no settled definition of 'beneficial ownership'".[22] This was not a good starting point for the Crown. The decision of the lower court came from Chief Justice Ripp, who at the time was Associate Chief Justice. Justice Ripp's famously sound reasoning withstood

[17] Michael N. Kandev, and Matthew Peters, "Treaty Interpretation: The Concept of 'Beneficial Owner' in Canadian Tax Treaty Theory and Practice" Report of Proceedings of the Sixty-Third Tax Conference (2011) 2011 Tax Conference (Toronto: CTF, 2012) 1-60.
[18] Organization for Economic Cooperation and Development Committee on Fiscal Affairs, *Model Tax Convention on Income and on Capital*, (2010) OECD Publishing: http://dx.doi.org/10.1787/978926417517-en.
[19] *Prévost Car Inc. v. Canada*, 2009 FCA 57.
[20] *Prévost Car Inc. v. The Queen*, 2008 TCC 231.
[21] *Ibid*.
[22] 2009 FCA 57 at paras. 7-8.

the test of review. In coming to its decision the FCA affirmed the TCC decision, citing the following from Justice Ripp's opinion:

> the "beneficial owner" of dividends is the person who receives the dividends for his or her **own use and enjoyment** and assumes the risk and control of the dividend he or she received. ... When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients.[23]

In other words, unless the original transferee corporation can be characterized as an agent of the subsequent transferees, in that it acted as agent and had no discretion to issue dividends, or if there is reason to pierce the corporate veil as a result of the original transferee corporation being merely a conduit with no discretion acting on an individual's behalf, the original transferee will be the beneficial owner.

Prévost Car was a seminal case in Canadian tax treaty jurisprudence and generated substantial commentary and critique, specifically in the context of treaty shopping. One of the key issues is how the term "beneficial owner" has been defined differently in the various jurisdictions because the OECD Model Treaty does not provide a definition. One commentator has noted that "[i]n theory, the [OECD Model Treaty] and its commentaries are an authoritative primary point of reference in interpreting Canada's tax treaties ... however, the relevance of particular commentaries and the weight to be given to them, if relevant, must carefully be tested on a case-by-case basis in light of the applicable context."[24] This author warns that the OECD

---

[23] *Ibid*. at para. 13 (citing *Prévost Car Inc. v. The Queen*, 2008 TCC 231) (emphasis added).

[24] Michael N. Kandev, and Matthew Peters, "Treaty Interpretation: The Concept of 'Beneficial Owner' in Canadian Tax Treaty Theory and Practice" Report of Proceedings of the Sixty-Third Tax Conference (2011) 2011 Tax Conference (Toronto: CTF, 2012) 1-60 at 26:32.

Model Treaty cannot be relied upon, and that domestic decisions will govern the applicable definition of "beneficial owner".

Further buttressing this point is the recent release of the OECD clarification on the issue, entitled "Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention" (the "**Draft Discussion**").[25] In addition to the "use and enjoyment" test similar to that expressed in the *Prévost Car* decision, the Draft Discussion included a new "facts and circumstances" test. It has been expressed that such a test runs contrary to Canadian jurisprudence:

> By stating that "facts and circumstances" should be taken into account in making the determination of beneficial ownership, the draft discussion diverges from the general prior understanding (and the conclusion of the courts in [*Prévost Car*]) that the recipient corporation that is the legal owner is also the beneficial owner of the dividends unless it is a nominee, agent or conduit. This broader interpretation could lead to tax authorities more generally attacking international holding company and financing company structures and introducing significant uncertainty for multinational companies.[26]

The varying tests not only create an ambiguous interpretational environment for tax planners but also create a more oppressive environment for taxpayers by imposing more onerous tests. The draft discussion, however, does not represent majority opinion; therefore, until the courts or legislature incorporate this meaning into Canada's domestic law, it cannot be relied upon for tax planning purposes.

One last caveat with respect to how treaty shopping is domestically enforced is the legislation governing its enforcement. On the one hand the treaty itself may have provisions (such as the limitation on benefits provisions noted above) designed to curb treaty shopping, but

[25] Organization for Economic Cooperation and Development, Centre for Tax Policy and Administration, (2011) *Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention*, online: OECD < http://www.oecd.org/tax/taxtreaties/47643872.pdf >.

[26] Richele Frank and Jerry Mahnger, "Top 10 International Tax Issues Impacting Small- and Medium-Sized Business" (2011) British Columbia Tax Conference (Vancouver: Canadian Tax Foundation) 13:1-27 at 13:6/7.

on the other, there may be specific domestic legislation created to police such activities. In Canada, there is no such legislation, and so the CRA relies on the amorphous GAAR, creating even more uncertainty for taxpayers:

> Canada does not have specific domestic anti-treaty-shopping legislation. Instead ... Canada relies principally on the [GAAR] to counter treaty-shopping situations. In this respect, in 2005, the GAAR was retroactively amended ... to explicitly apply to tax treaties.[27]

In addition, the commentator noted that "Prévost exemplifies the fact that treaty shopping is not necessarily abusive", confirming the above proposition that the Westminster Principle applies to treaty shopping.[28]

The above observations demonstrate the domestic jurisprudential landscape which prefaces any foray into treating shopping; however, the hunt for the jurisdiction that fits properly is riddled with decoys and distractions, and requires a meticulous search of the various jurisdictions.

IV. Searching the World

The following section will compare the main similarities and differences between a few sample treaties from the following four regions: the United States (as a region of itself), East Asia, the Caribbean and Europe. The main focus of the analysis will be on Treaty Shopping and Anti-avoidance Provisions, Dividend\Interest Withholding Tax Rate, the Jurisdiction's General Corporate Income Tax Rate, Other Business Considerations, and any Substantial Departure from the OECD Model Treaty.

---

[27] Michael N. Kandev, "Treaty Shopping After Prévost Car: What Does the Future Hold?" in International Tax Seminar, 2009 (Kingston, ON: International Fiscal Association (Canadian Branch)) 3:1-25 at 3:4.
[28] *Ibid*. at 3:12.

a. USA

Country	Treaty Shopping\Anti-avoidance Provision(s)	Lowest Dividend\Interest Withholding Tax Rate	Jurisdiction's General Corporate Income Tax Rate[29][30]	Other Business Considerations	Substantial Departure from OECD Model Treaty
USA[31]	☠ Article IX - Related Persons ☠Article XXVII - Exchange of Information ☠ Beneficial Owner Provision **☠ Article XXIX A - Limitation on Benefits**	5%\15%[32]	39.1%[33]	👍 Beneficial owner of dividends must have at least 10% ownership[34] ☠ Provides a "look-through" rule for LLC's which determines the residence of the LLC based on the residence of the owners of the entity but increases the compliance burden on Canadians[35]	☠ Article XXIX A – Limitation on Benefits Provision

29 "OECD Corporate Income Tax Rates, 1981-2012" *United States Tax Foundation* (29 June 2012), online: The Tax Foundation < http://taxfoundation.org/article/oecd-corporate-income-tax-rates-1981-2012 >.
30 Note that the corporate income tax rate is highly variable and dependent on a number of factors. For the purpose of this paper the rates have been chosen to reflect either the highest domestic rate or preferential international rates (as indicated).
31 *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital*, 26 September 1980, S.C. 1984, c.20, Part I.
32 *Ibid*. at Articles X(2)(a), XI(6)(a).
33 Varies by state and territory.
34 *Supra* note 31 at Article X(2)(a).
35 Brad Gordica and Sara McCracken, "Canada-US Protocol: Top Five Issues for Cross-Border Businesses," (2009) British Columbia Tax Conference, (Vancouver: Canadian Tax Foundation) 9:1-56 at 9:4/5 ("As a practical matter, the disparate tax treatment between US and non-US resident members of a US LLC investing in Canada will **increase the compliance burden on Canadian payers** by requiring them to identify the LLC members in order to determine the appropriate level of withholding" (emphasis added)).

b. East Asia

Country	Treaty Shopping\Anti-avoidance Provision(s)	Lowest Dividend\Interest Withholding Tax Rate	Jurisdiction's General Corporate Income Tax Rate[36]	Other Business Considerations	Substantial Departure from OECD Model Treaty
China	☠ Article 9 - Associated Enterprises ☠ **Article 16 - Directors' Fees and Remuneration of Top-Level Managerial Officials** ☠ Article 24 - Exchange of Information ☠ Beneficial Owner Provision	10%\10%[37]	25%[38]	👍 Regulatory framework is oppressive and prohibitive in some cases[39] 👍 Beneficial owner of dividends must have at least 10% ownership[40] ☠ The nature of China's legislation makes predicting changes very difficult[41]	☠ "[W]hen read together with section 6.3 of the Income Tax Conventions Interpretation Act, RSC 1985, c. I-4, results in no capital gains exemption."[42]
Japan	☠ **Article 9 - Direct or Indirect Management and Control** ☠ Article 16 - Directors' Remuneration ☠ Article 24 - Exchange of Information ☠ Beneficial Owner Provision	5%\10%[43]	39.5%	👍 Beneficial owner of dividends must have at least 25% ownership[44] ☠ Uses a territorial system of taxation creating uncertainty for tax planners	☠ "[W]hen read together with section 6.3 of the Income Tax Conventions Interpretation Act, RSC 1985, c. I-4, results in no capital gains exemption."[45]
South Korea	☠ **Article 9 - Direct or Indirect Management and Control** ☠ Article 16 - Directors' Fees ☠ Article 25 - Exchange of Information ☠ Beneficial Owner Provision	5%\10%[46]	24.2%	👍 Beneficial owner of dividends must have at least 25% ownership[47] ☠ Article 13(5) – Deems that proceeds of disposition of part of a "substantial interest" in a corporation (defined as 25% or more) that is a resident of a contracting state may be taxed in that state	☠ Article 13(5) – "Substantial Interest" Deeming Provision

[36] *Supra* note 29.
[37] *Agreement Between the Government of Canada and the Government of the People's Republic of China*, 12 May 1986, S.C. 1986, c.48, Part III, Articles 10(2)(a), 11(2).
[38] "Overview of PRC Taxation System" *Price Waterhouse Cooper* (2012), online: The Tax Foundation < http://www.pwchk.com/home/eng/prctax_corp_overview_taxation.html >.
[39] Bill Lau, Harriet Man, and Roger Di, "Pan-Asian Outbound Investment: Key Tax and Structuring Issues", Report of Proceedings of Sixty-Second Tax Conference, 2010 Tax Conference (Toronto: Canadian Tax Foundation, 2011), 26:1-33 at 2.
[40] *Supra* note37, Article 10(2)(a).
[41] **See** *Supra* note 39 at 26:2/3 ("The Ministry of Finance and the State Administration of Taxation (SAT) are empowered to interpret the tax laws and regulations by means of the publication of ad hoc tax circulars. China's tax system reflects the complexity of its legal system. There is no single tax law governing the taxation of individuals and enterprises.")
[42] Alan Bowman, "Taxable Canadian Property," Report of Proceedings of Sixty-Second Tax Conference (2010) Tax Conference (Toronto: Canadian Tax Foundation), 32:1-24 at 32:3.
[43] *Convention between the Government of Canada and the Government of Japan*, 7 May 1986, S.C. 1986, c.48, Part II, Articles 10(2)(a), 11(2).
[44] *Ibid.*, Article 10(2)(a).
[45] *Supra* note 42 at 32:3.
[46] *Convention between the Government of Canada and the Government of the Republic of Korea*, 10 February 1978, S.C. 1980-81-82-83, c.44, Part IV, Articles 10(2)(a), 11(2).
[47] *Ibid.*, Article 10(2)(a).

c. The Caribbean

Country	Treaty Shopping\Anti-avoidance Provision(s)	Lowest Dividend\Interest Withholding Tax Rate	Jurisdiction's General Corporate Income Tax Rate	Other Business Considerations	Substantial Departure from OECD Model Treaty
Barbados	Article IX - Associated Enterprises **Article XIII - Management Fees** Article XVII - Directors' Fees Article XXVIII - Exchange of Information Beneficial Owner Provision	15%\15%[48]	25% (1% for foreign corporations)[49]	"[A]lthough Barbados imposes a significant corporate income tax rate (currently, 25 percent), a qualifying **international business corporation (IBC)** is subject to a maximum Barbados rate of **2.5 percent**. Also, the IBC is not required to withhold tax from dividends that it pays to its non-resident shareholders."[50]	Exemption from treaty carved out for IBC's at Article XXX(3) Article XIII – Management Fees
Jamaica	Article IX - Associated Enterprises **Article XIII - Management Fees** Article XVII - Directors' Fees Article XXVI - Exchange of Information Beneficial Owner Provision	22.5%\15%[51]	33.33%[52]	Beneficial owner of dividends must have at least 10% ownership[53]	Article XIII – Management Fees
Turks and Caicos Islands[54]	The treaty is an information exchange agreement designed to expose unlawful investment\shelters	[55]	0%[56]	History of cooperative dealings with Canadian business	N/A

[48] *Agreement Between Canada and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital*, 22 January 1980, S.C. 1980-81-82-83, c.44, Part IX, Articles X(2), XI(1).

[49] "Barbados Highlights 2012" *Deloitte International Tax* (2012), online: Deloitte < online: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/2012/dttl_tax_highlight_2012_Barbados.pdf >.

[50] Perry Truster, "Barbados a Preferred Haven for Offshore Business Income" (2011) vol. 12, no. 4 Tax for the Owner Manager, at 8-9 (emphasis added).

[51] *Agreement Between the Government of Canada and The Government of Jamaica*, 30 March 1978, S.C. 1980-81-82-83, c.44, Part III, Articles X(3), XI(2).

[52] "Corporate tax rates table" *KPMG Global* (2012), online: KPMG < http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx >.

[53] *Supra* note 51, Article X(3).

d. Europe

Country	Treaty Shopping\Anti-avoidance Provision(s)	Lowest Dividend\Interest Withholding Tax Rate	Jurisdiction's General Corporate Income Tax Rate[57]	Other Business Considerations	Substantial Departure from OECD Model Treaty
Germany	☠ Article 9 - Associated Enterprises ☠ Article 16 - Directors' Fees ☠ Article 26 - Exchange of Information ☠ Beneficial Owner Provision	5%\10%[58]	30.2%	👍 Beneficial owner of dividends must have at least 10% ownership[59] 👍☠ Safe banking and investment regime but relatively high rates of interest and tax	N/A
Italy	☠ Article 9 - Associated Enterprises ☠ Article 16 - Directors' Fees ☠ Article 25 - Exchange of Information ☠ Beneficial Owner Provision	5%\10%[60]	27.5%	👍 Beneficial owner of dividends must have at least 10% ownership[61] ☠ Poor economy and unenviable tax collection regime ☠ "The beneficial owner must have an autonomous organization to provide services and must bear the entrepreneurial risks of such activity."[62]	N/A
Russia	☠ Article 9 - Adjustments to Income ☠ Article 16 - Director	10%\10%[63]	20%[64]	👍 Beneficial owner of dividends must have at least 10% ownership[65]	Article 28 – Special Provisions, exemptions vis-a-vis Cyprus

[54] The Turks and Caicos Islands is a Territory of the United Kingdom but has engaged in a separate tax agreement with Canada, *inter alia*, for the purpose of sharing information and avoiding double taxation: See *Agreement between the government of Canada and the government of the Turks and Caicos Islands under entrustment from the government of the United Kingdom of Great Britain and Northern Ireland for the exchange of information on tax matters*, 22 June 2010, online: Ministry of Finance < http://www.fin.gc.ca/treaties-conventions/turks2-agree-eng.asp >.

[55] Does not reference withholding taxes on dividends or interest.

[56] "Corporate tax rates 2012" *Deloitte International Tax* (2012), online: Deloitte < http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/matrices/dttl_corporate_tax_rates_2012.pdf >.

[57] "OECD Corporate Income Tax Rates, 1981-2012" *United States Tax Foundation* (29 June 2012), online: The Tax Foundation < http://taxfoundation.org/article/oecd-corporate-income-tax-rates-1981-2012 >.

[58] *Agreement Between Canada and the Federal Republic of Germany for the Avoidance of Double Taxation With Respect to Taxes on Income and Certain Other Taxes, the Prevention of Fiscal Evasion and the Assistance in Tax Matters*, 17 July 1981, S.C. 1980-81-82-83, c.156, Articles 10(2)(a), 11(2).

[59] *Ibid.*, Article 10(2)(a).

[60] *Convention Between the Government of Canada and the Government of the Italian Republic For the Avoidance of Double Taxation With Respect to Taxes on Income and the Prevention of Fiscal Evasion*, 17 November 1977, S.C. 1980-81-82-83, c.44, Part III, Articles 10(2)(a), 11(2).

[61] *Ibid.*, Article 10(2)(a).

[62] Michael N. Kandev, and Matthew Peters, "Treaty Interpretation: The Concept of 'Beneficial Owner' in Canadian Tax Treaty Theory and Practice" Report of Proceedings of the Sixty-Third Tax Conference (2011) 2011 Tax Conference (Toronto: CTF, 2012) 1-60 at 26:44/45.

[63] *Agreement between the Government of Canada and the Government of the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital*, 5 October 1995, S.C. 1996, c.27, Part I, Articles 10(2)(a), 11(2).

[64] "Corporate tax rates table" *KPMG Global* (2012), online: The Tax Foundation < http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx >.

[65] *Supra* note 63, Article 10(2)(a).

	Fees ☠ Article 25 - Exchange of Information ☠ **Article 28 - Special Provisions** ☠ Beneficial Owner Provision			👍 Exceptions exist in Russian law which allow structuring through Cyprus to gain benefits which exceed those available under the Canada-Russia tax treaty[66]	

It should be noted that the courts have determined that the GAAR applies, and in fact trumps, treaty provisions where an avoidance transaction is identified by the CRA. In *RMM*, a non-arm's length Canadian corporation used its relationship with a US corporation to circumvent its withholding obligation using the Canada-US tax treaty.[67] Justice Bowman held that:

> Canada is a party to a large number of income tax conventions .... It would be a surprising conclusion that Canada ... had intentionally or inadvertently bargained away its right to deal with tax avoidance or tax evasion by residents of treaty countries in its own domestic tax laws. It would be equally surprising if tax avoidance schemes that are susceptible of attack under either general anti-avoidance provisions or specific anti-avoidance rules, if carried out by Canadian residents, could be perpetrated with impunity by non-residents under the protection of a treaty. That is not what treaties are for.[68]

This demonstrates the primacy of domestic law regardless of treaties in the case of a very discretionary CRA interpretive arena: the GAAR.

In addition, the Canadian courts have adopted the "Central Management and Control" test in determining the residence of corporations and trusts. In *De Beers*, a British case adopted by the Canadian courts, a diamond trading company had its office registered and incorporated in South Africa in order to operate and coordinate its mining and distributing business. The directors of the corporation were resident in both South Africa and England, though the majority of the directors resided in London and were required to be consulted on, or in some cases approve,

[66] Bill Lau, Harriet Man, and Roger Di, "Pan-Asian Outbound Investment: Key Tax and Structuring Issues," Report of Proceedings of Sixty-Second Tax Conference (2010) Tax Conference (Toronto: Canadian Tax Foundation), 26:1-33 at 26:28-29.
[67] *RMM Canadian Enterprises Inc. v. Canada*, [1997] T.C.J. No. 302.
[68] *Ibid. at* para. 56.

major decisions and expenditures. The British court held that the corporation, for tax purposes, was resident in England, holding that:

> In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business.... [A] company resides for purposes of income tax where its real business is carried on ... and the real business is carried on where the **central management and control** actually abides.[69]

The concept was recently applied to trusts by the Supreme Court of Canada.[70] Keeping these considerations in mind will provide the guidance necessary to find the right foot on which to place the shoe, regardless of the jurisdiction in question.

V. If the Shoe Fits

The countries featured in the charts above were chosen because cumulatively they provide a breadth of variables which appear among the various treaties. Some of those considerations include low tax rate, cooperative government and regulatory environment, preferential treatment of foreign entities, "look through" and "associated enterprises" rules, etc.

Each of these criteria must be carefully considered before entering into a structure; however, perhaps the most important factor is determining at what point the beneficial owner will be deemed a resident of an undesirable jurisdiction. As was seen above, some jurisdictions allow for exceptions in the treaties (such as Russia's exception for Cyprus and Barbados' exception for IBC's).

The key to determining the correct jurisdiction is in the facts. The tax planner should be aware of the general differences between tax treaties and approach the client's structuring plan with the following ten step analysis:

[69] *De Beers Consolidated Mines v. Howe (Surveyor of Taxes)*, [1906] A.C. 455 (emphasis added).
[70] *Fundy Settlement v. Canada*, 2012 SCC 14.

1. Where is the client's business or client's corporation resident?
    a. Are the assets of the business held in trust, by a corporation, or some other entity?
2. Look to Canada's domestic tax law:
    a. Where is the central management and control?
    b. Is this an avoidance transaction (i.e. potentially subject to the GAAR)?
3. Does it do business internationally, and if so, in which jurisdictions?
    a. If it does, what treaties exist with those jurisdictions?
4. Does the client wish to invest in other jurisdictions?
5. Would the client qualify for a reduced tax rate in a treaty jurisdiction?
    a. If so, which ones and what are the treaty benefits\costs of each?
6. Can the client move its operations so that it satisfies the residency requirements in the treaty jurisdiction?
    a. If so, is it willing to do so?
7. What other business considerations are there with respect to the jurisdiction which is ultimately being considered?
    a. Examples of this include whether the regulatory environment is unduly oppressive and whether an information exchange agreement would impose unduly oppressive and costly reporting requirements
8. What is the domestic tax law landscape like in the chosen jurisdiction, and how does its domestic law interpret similar language (such as "Beneficial Owner")?
9. What are the applicable provisions of the treaty?
    a. Are there specific avoidance provisions that may apply?
10. Finally, is it possible to objectively determine the benefit of shifting the tax burden to a treaty jurisdiction, and does that figure justify the move?

If these questions are answered and the proper objective analysis is conducted, then the client can and should be able to make the move safely without the need for any magic.

VI. Happily Ever After

This paper began by illustrating that finding the right jurisdiction for a tax structure can be an unpleasant story. There are no tax treaties between Canada and fairy tale land, so at some point reality will set in and spoil the fantasy of low tax rates and dreams of friendly governments handing out subsidies. When seeking out a jurisdiction to assist in an off shore structure, the tax planner must undertake the arduous task of investigating the domestic and international landscape governing the tax relationship between Canada and the intended jurisdiction.

Tax planners must also be wary of Canada’s attitude towards such structures. The CRA continues to undertake a program of militant enforcement against off shore structures. Adding to this confrontational attitude is the fact that it uses the GAAR to do so, an amorphous provision of the Act, the broadness of which fosters unpredictability in its application. Once it is deemed safe to proceed from a domestic standpoint, several business consideration must be made, after which an analysis of the treaty itself should be performed in order to determine whether an avoidance transaction could be deemed, or whether the treaty thwarts attempts at reaping a tax benefit through specific anti-avoidance provisions. If the structure is ultimately deemed clear then the business or investment can proceed in its new happy home.

Being successful in business is like being invited to the ball; but stumbling into an ill conceived structure is like showing up without proper attire: it’s not pretty. Full disclosure and proper planning will properly protect the business from unduly harsh compliance requirements and double taxation, as well as reduce the tax burden on the business, thereby allowing the business owners to retain far more of the earnings and live happily ever after.

Bibliography

Legislation

1. Income Tax Act, R.S.C. 1985, (5th Supp) c.1.

Tax Conventions

1. *Agreement Between Canada and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital*, 22 January 1980, S.C. 1980-81-82-83, c.44, Part IX.
2. *Agreement Between Canada and the Federal Republic of Germany for the Avoidance of Double Taxation With Respect to Taxes on Income and Certain Other Taxes, the Prevention of Fiscal Evasion and the Assistance in Tax Matters*, 17 July 1981, S.C. 1980-81-82-83, c.156.
3. *Agreement Between the Government of Canada and The Government of Jamaica*, 30 March 1978, S.C. 1980-81-82-83, c.44, Part III.
4. *Agreement Between the Government of Canada and the Government of the People's Republic of China*, 12 May 1986, S.C. 1986, c.48, Part III.
5. *Agreement between the Government of Canada and the Government of the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital*, 5 October 1995, S.C. 1996, c.27, Part I.
6. *Agreement between the government of Canada and the government of the Turks and Caicos Islands under entrustment from the government of the United Kingdom of Great Britain and Northern Ireland for the exchange of information on tax matters*, 22 June 2010, online: Ministry of Finance < http://www.fin.gc.ca/treaties-conventions/turks2-agree-eng.asp >.
7. *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital*, September 26, 1980, S.C. 1984, c.20, Part I.
8. *Convention between the Government of Canada and the Government of Japan*, 7 May 1986, S.C. 1986, c.48, Part II.
9. *Convention between the Government of Canada and the Government of the Republic of Korea*, 10 February 1978, S.C. 1980-81-82-83, c.44, Part IV.
10. *Convention Between the Government of Canada and the Government of the Italian Republic For the Avoidance of Double Taxation With Respect to Taxes on Income and the Prevention of Fiscal Evasion*, 17 November 1977, S.C. 1980-81-82-83, c.44, Part III.

Case Law

1. *Fundy Settlement v. Canada*, 2012 SCC 14.

1. *Prévost Car Inc. v. Canada*, 2009 FCA 57.
2. *MIL (Investments) S.A. v. Canada*, 2006 TCC 460.
3. *Prévost Car Inc. v. The Queen*, 2008 TCC 231.
4. *RMM Canadian Enterprises Inc. v. Canada*, [1997] T.C.J. No. 302.
5. *De Beers Consolidated Mines v. Howe (Surveyor of Taxes)*, [1906] A.C. 455.
6. *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.)

CRA, NGO and Government Publications

1. Advisory Panel on Canada's International Tax System, "Enhancing Canada's International Tax Advantage: A Consultation Paper Issued by the Advisory Panel on Canada's System of International Taxation" (Ottawa: APCSIT, April 2008).
2. Organization for Economic Cooperation and Development Committee on Fiscal Affairs, *Model Tax Convention on Income and on Capital*, (2010) OECD Publishing: http://dx.doi.org/10.1787/978926417517-en.
3. Organization for Economic Cooperation and Development, Centre for Tax Policy and Administration, (2011) *Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention*, online: OECD < http://www.oecd.org/tax/taxtreaties/47643872.pdf >.

Secondary Sources

1. Tony J. Ancimer, "International Tax Update for Non-Specialists" (2007) Ontario Tax Conference, (Toronto: Canadian Tax Foundation) 2:1-32.
2. Alan Bowman, "Taxable Canadian Property," Report of Proceedings of Sixty-Second Tax Conference (2010) Tax Conference (Toronto: Canadian Tax Foundation), 32:1-24.
3. Marc Darmo and Angelo Nikolakakis, "The New Rules on Limitation on Benefits and Fiscally Transparent Entities" Report of Proceedings of Sixty-First Tax Conference, 2009 Tax Conference (Toronto: Canadian Tax Foundation, 2010) 26:1.
4. David Bishop Debenham "From the Revenue Rule to the Rule of the 'Revenuer': A Tale of Two Davids and Two Goliaths" (2008) 56 CTJ 1-66.
5. Richele Frank and Jerry Mahnger, "Top 10 International Tax Issues Impacting Small- and Medium-Sized Business" (2011) British Columbia Tax Conference (Vancouver: Canadian Tax Foundation) 13:1-27.
6. Brad Gordica and Sara McCracken, "Canada-US Protocol: Top Five Issues for Cross-Border Businesses," (2009) British Columbia Tax Conference, (Vancouver: Canadian Tax Foundation) 9:1-56.
7. Michael N. Kandev, and Matthew Peters, "Treaty Interpretation: The Concept of 'Beneficial Owner' in Canadian Tax Treaty Theory and Practice" Report of Proceedings of the Sixty-Third Tax Conference (2011) 2011 Tax Conference (Toronto: CTF, 2012) 1-60.
8. Michael N. Kandev, "Treaty Shopping After Prévost Car: What Does the Future Hold?" in International Tax Seminar, 2009 (Kingston, ON: International Fiscal Association (Canadian Branch)) 3:1-25.
9. Bill Lau, Harriet Man, and Roger Di, "Pan-Asian Outbound Investment: Key Tax and Structuring Issues", Report of Proceedings of Sixty-Second Tax Conference, 2010 Tax Conference (Toronto: Canadian Tax Foundation, 2011), 26:1-33.
10. Mária Tatarová, "Hybrid Mismatch Arrangements: The OECD Report and the Canadian Perspective" (2012) 3 CTJ 701.
11. Perry Truster, "Barbados a Preferred Haven for Offshore Business Income" (2011) vol. 12, no. 4 Tax for the Owner Manager.

Electronic Resources

1. “Barbados Highlights 2012” *Deloitte International Tax* (2012), online: Deloitte < online: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/2012/dttl_tax_highlight_2012_Barbados.pdf >.
2. “Corporate tax rates 2012” *Deloitte International Tax* (2012), online: Deloitte < http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/matrices/dttl_corporate_tax_rates_2012.pdf >.
3. “Corporate tax rates table” *KPMG Global* (2012), online: KPMG < http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx >.
4. “OECD Corporate Income Tax Rates, 1981-2012” *United States Tax Foundation* (29 June 2012), online: The Tax Foundation < http://taxfoundation.org/article/oecd-corporate-income-tax-rates-1981-2012 >.
5. “Overview of PRC Taxation System” *Price Waterhouse Cooper* (2012), online: The Tax Foundation < http://www.pwchk.com/home/eng/prctax_corp_overview_taxation.html >.
6. “Tax Treaties” *Canada Revenue Agency* (2012), online: CRA < http://www.cra-arc.gc.ca/tx/nnrsdnts/trty-eng.html >.