

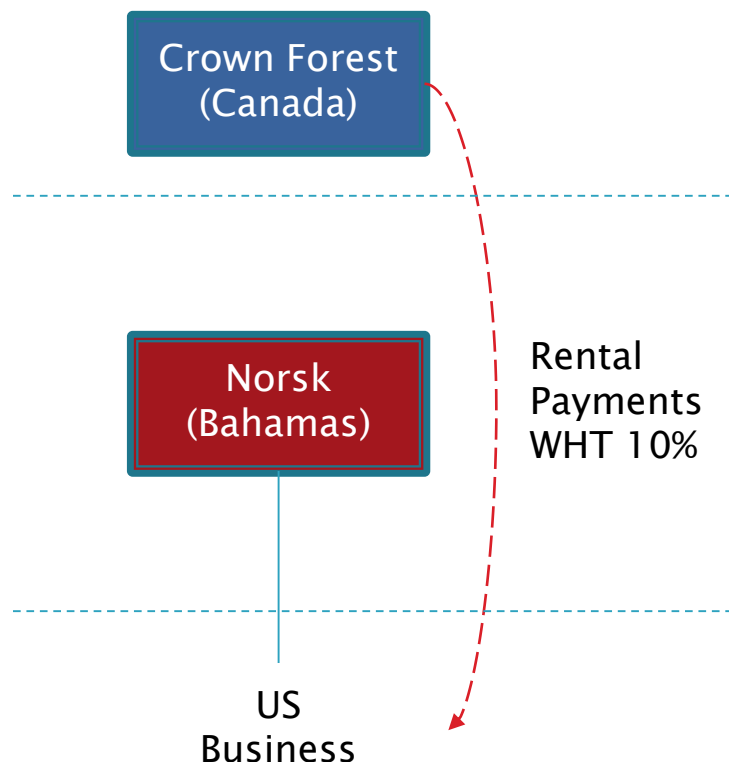
# MULTILATERAL INSTRUMENT (MLI) WHAT YOU NEED TO KNOW

**NANCY YAN - CADESKY TAX**

**NADIA RUSAK - CRAGMORE**

# PRE-MLI CASE LAW AND TAX RULES

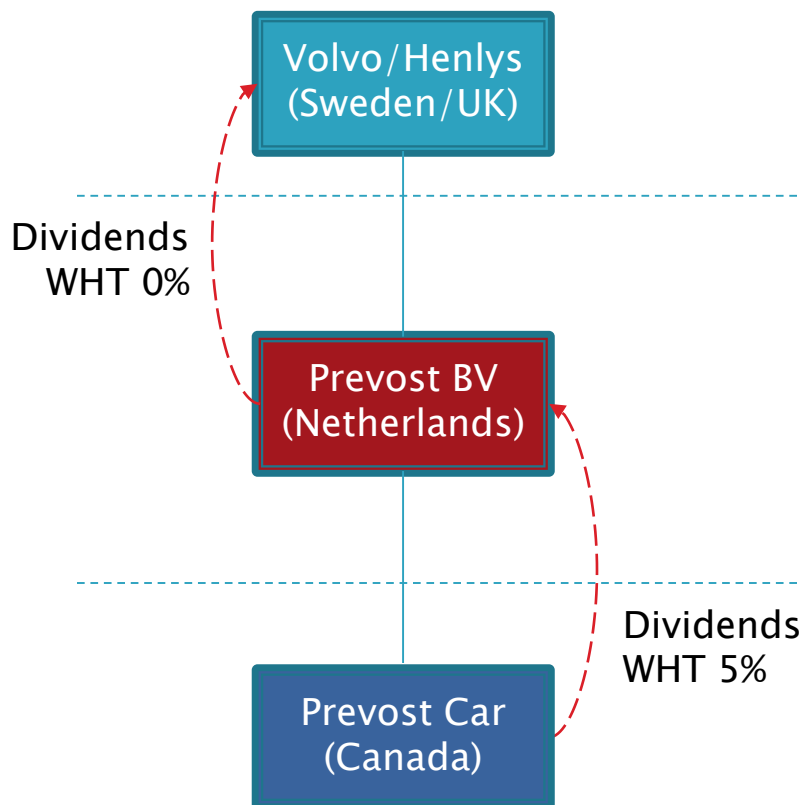
# Pre-MLI Case Law



## ***Crown Forest (SCC, 1995)***

- SCC considered the issue of residence for the purpose of applying WHT to barge rental payments made by Crown Forest to Norsk's US branch
- SCC held that the term "resident" for purposes of US-Canada Treaty means liable to tax on worldwide income
- Norsk was subject to tax in the US on US source income only and therefore did not qualify
- SCC stated that treaties should be given liberal interpretation with a view of implementing true intention of the parties
- SCC relied on the commentary to the 1963 OECD model tax treaty to find the object and purpose of the treaty and the intent of the drafters

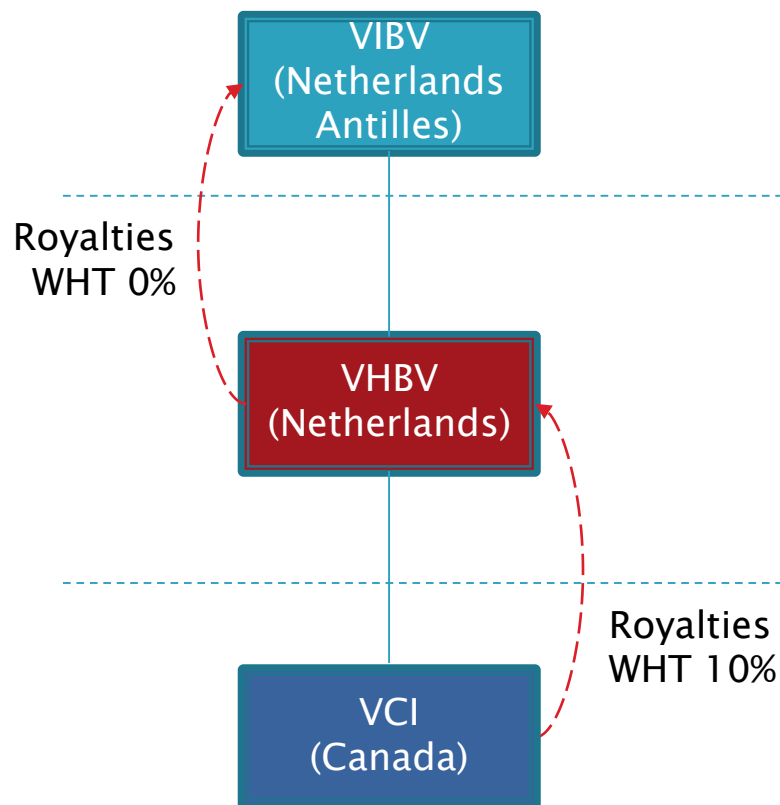
# Pre-MLI Case Law



## ***Prevost Car* (FCA, 2009)**

- CRA challenged the application of Art. X of the Canada-Netherlands treaty to dividend payments received by a holding company (Prevost BV) on the basis that the beneficial owner of the dividends was not the holding company but the shareholders of the holding company (Volvo/Henlys)
- TCC and FCA relied on the commentary to the 1977 OECD model treaty to inform the meaning of “beneficial owner”
- Since the commentary did not elaborate on the term “beneficial owner”, the court went on to establish the meaning of the term under the ITA (as required by the ITCIA)
- The court refused to import anti-avoidance or anti-conduit judicial doctrines that was not clearly expressed in the treaty or the commentary

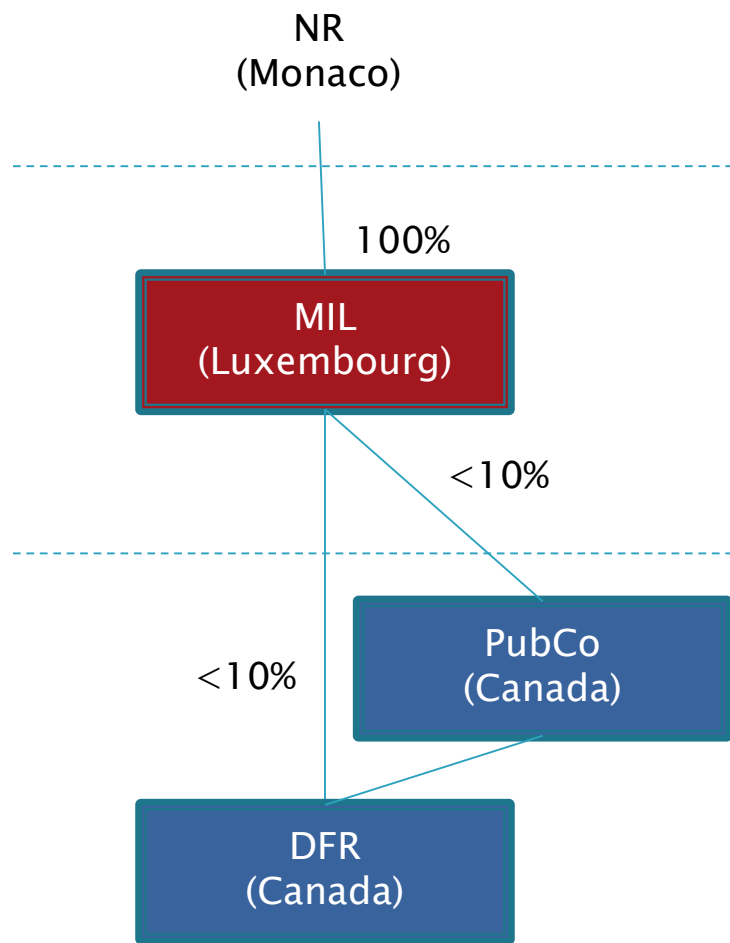
# Pre-MLI Case Law



## **Velcro (TCC, 2012)**

- CRA challenged the application of Art. XII of the Canada-Netherlands treaty to royalty payments received by a holding company (VHBV) in a back-to-back royalty scenario arguing that the ultimate shareholder (VIBV) was the beneficial owner of the royalties
- TCC applied the test for beneficial ownership from *Prevost Car* (possession, use, risk and control) and concluded that the holding company was the beneficial owner
- TCC confirmed the relevance of the OECD commentary and the OECD conduit report
- Since 2014, Velcro-type situations are covered by back-to-back WHT rules in s. 212(3.1)-(3.94)

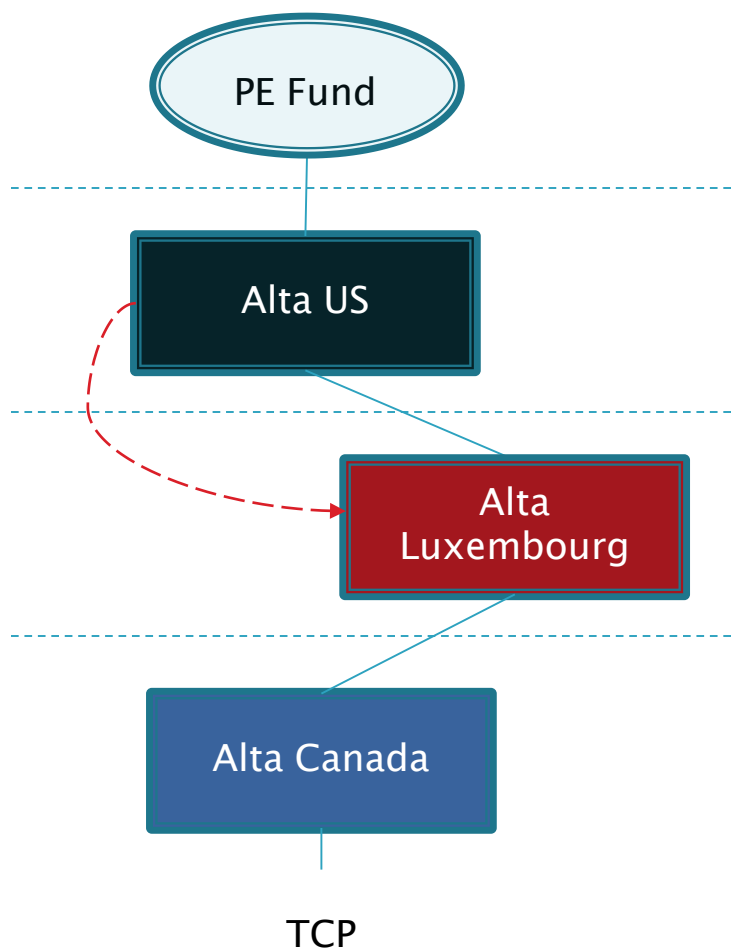
# Pre-MLI Case Law



## **MIL (FCA, 2007)**

- MIL was continued from Cayman Islands to Luxembourg before the sale of shares of DFR and claimed the exemption under Art. 13 of Canada-Luxembourg Treaty
- CRA reassessed MIL under GAAR
- Art. 13 was not in the OECD Commentary, so the court interpreted the text based on the plain meaning, context and purpose of the provision
- Since Art. 13 provided for a specific exemption from Canadian tax that was negotiated by Canada and Luxembourg, taking advantage of that exemption cannot be abusive
- Thus, GAAR did not apply

# Pre-MLI Case Law



## ***Alta Energy (TCC, 2018)***

- CRA attempted to apply GAAR to deny the benefit of Art. 13(4) of Canada-Luxembourg Treaty with respect to a capital gain realized by Alta Energy on TCP shares
- Like in MIL, the court noted the departure of the treaty from the OECD model and interpreted Art. 13(4) in light of the presumed intention of the drafters to grant a specific exemption for business-use property
- Treaty-shopping is policed by the “beneficial ownership” requirement and LOB, the former being satisfied here and the latter being absent from the treaty
- The preamble to the treaty (which referred to the object of preventing fiscal evasion) was too vague to inform the interpretation of any specific article of the treaty
- Thus, no misuse or abuse of treaty provisions and GAAR did not apply

# Pre-MLI Legislative Efforts

- 2014 Department of Finance proposals on treaty shopping (put on hold pending BEPS)
- 2016 Federal Budget announcement to address treaty abuse through MLI and bilateral negotiations
- 2014/2016 back-to-back rules in Part XIII



# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### General

- MLI first released on November 24, 2016 by the OECD pursuant to action 15 of 2014 BEPS Report.
- MLI enters into force for a country on the 1<sup>st</sup> day of the month beginning 3 months after the country deposits its instrument of ratification with the OECD.
- 38 of 93 Jurisdictions have deposited instrument of Ratification, Acceptance or Approval.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### **General**

- Not meant to replace existing tax treaties but modify their application to implement BEPS measures.
- MLI signatories must agree to adopt minimum standards.
- Allows jurisdictions to opt in or opt out of provisions beyond the minimum standards.

# MULTILATERAL INSTRUMENT (MLI) WHAT YOU NEED TO KNOW?

## General

- Method - reservation and notification process.
- Reservations may modify some or all of the treaties.
- Reservations may be removed after ratification but no new ones may be added.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### General

- Other countries' reservation will also modify Canada's treaty with the other countries.
- Conflict: to be addressed by compatibility clauses.
- MLI provisions to be interpreted in good faith and in accordance with the ordinary meaning, in their context, and in the spirit of the treaty's object and purpose.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### General

- See step-by-step by OECD for applying the MLI.
- See MLI Matching Database (beta) – [www.oecd.org/tax/treaties/mli-matching\\_database.htm](http://www.oecd.org/tax/treaties/mli-matching_database.htm)
- FAQ from OECD.
- Sample synthesized MLI provided in pre-readings.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada

- MLI Bill C – 82 – received Royal assent on June 21, 2019.
- Enters into force on December 1, 2019.
- Enters into effect for Canada's treaties on January 1, 2020 for withholding taxes.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada

- Other taxes (including capital gains) for taxation year beginning on or after June 1, 2020. Thus for calendar year ends, January 1, 2021.
- Treaty partners that have not completed procedure to have MLI to come into effect, MLI came into effect when:
  - 1) withholding taxes – 1<sup>st</sup> day of calendar year that begins on or after the date on which MLI enters into force for the other country; and
  - 2) other taxes – tax years beginning 6 months after MLI enters into force for the other country.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada

- Includes 84 of its 93 treaties.
- Does not affect treaties with:
  - United States (did not sign MLI)
  - German and Switzerland (bilateral treaty negotiation)



# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada

- Ecuador, Guyana, Kyrgyzstan, Taiwan, Uzbekistan
- See status of List of Reservations and Notifications upon Deposit of Instrument of Ratification (Canada) deposited on August 29, 2019.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada - Adopts

Minimum standards and optional binding arbitration for treaty disputes, include:

- Article 4 - Dual Resident Entities  
(tie-breaker rules provided also agreed to by treaty partner)
- Article 6 - Purpose of Covered Tax Agreement
- Article 7 - Prevention of Treaty Abuse (PPT)

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada - Adopts

- Article 8 - One-year holding test to benefit from reduced withholding rate on dividends.
- Article 9 - One-year lookback for capital gains on disposition of shares / equity interests that derive their value principally from immovable properties.

# MULTILATERAL INSTRUMENT (MLI) WHAT YOU NEED TO KNOW?

## Canada – Adopts

- Article 16 - Mutual Agreement Procedure (MAP)
- Article 17 - Corresponding Adjustments
- Articles 18 to 26 - Mandatory Binding Arbitration

# MULTILATERAL INSTRUMENT (MLI) WHAT YOU NEED TO KNOW?

## Canada – Reservations

- Article 3 - Transparent Entities
- Article 5 - Methods for Elimination of Double Taxation  
(provision to allow to move from exemption to FTC system)
- Article 7 (4) - Benefit Denied Under PPT may still be granted under competent action.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada – Reservations

- Article 11 - Restrict right to tax its own residents.
- Article 12 - 14 - PE.
- Article 15 - Definition of a person closely related to an enterprise.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada – Reservations

- Article 16 - MAP – first sentence of Article 16 (1) and 2<sup>nd</sup> sentence of Article 16 (2).
- Re: (6c1) - Canada to permit presentation to competent authority of which the taxpayer is a resident.
- Re: 16(2) - See status of list of Reservations.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada – Reservations

- Article 17 - Corresponding adjustments.
- Article 19 - Various.
- Article 23 - Some types of arbitration process is not adopted if the other party has reserved.
- Article 26 - Compatibility – not to apply to treaties already containing mandatory binding arbitration.



# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada – Notifications

- Meant to inform where required by MLI where there are already similar provision treaties , or certain reservations mentioned in MLI do not apply to listed agreements with effect that the particular MLI provision to apply.
- For example, Article 8 (3) and (6), same for notification for Article 7 (15) (b) of the MLI.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT YOU NEED TO KNOW?

### Canada – Inconsistent Laws

- MLI prevail over other laws except where there is inconsistency between MLI and the Income Tax Conventions Interpretation Act (the “Act”), the Act prevails.

# MULTILATERAL INSTRUMENT (MLI) WHAT YOU NEED TO KNOW?

## How to make sense of the Reservations and Notifications

- Use the Matching Database on the OECD website.
- Can follow the flowchart prepared by the OECD Secretariat, e.g. how to interpret how Article 4 of the MLI applies to Canada and its treaty partners?

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 4 – Dual Resident Entities

- Applies to persons other than individual, e.g. corporations.
- To be determined by competent authority.
- Factors to take into account include: place of effective management, place of incorporation or otherwise constituted, “and any other relevant factors”.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 4 – Dual Resident Entities

- Silent on continuance of corporations.
- Note some of Canada's treaties have tie-breaker rules: where the entity is created (e.g. Canada-U.S., Cyprus, Switzerland treaties).

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES ALL THIS MEAN?

### Canada – Article 6 – Purpose of Treaties

- Article 6(1) - Change to preamble of Covered Tax Agreements to include in purpose statement that tax treaties are intended to eliminate double taxation without creating opportunities for non-taxation or reduced taxation.
- Meant to address treaty-shopping.
- Now benefits of a treaty will be scrutinized based on substance of activities in a particular treaty jurisdiction.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES ALL THIS MEAN?

### Canada – Article 6 – Purpose of Treaties

- Where Article 6(1) applies, it will modify a CTA to include the following preamble:
  - “Intending 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 agreement for the indirect benefit of residents of third jurisdictions)”.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES ALL THIS MEAN?

### Canada – Article 7 (1) – Principal Purpose Test

- Where article 7(1) applies, it will modify a CTA to include the following provision:
  - 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 that 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 these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.



# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES ALL THIS MEAN?

### Canada – Article 7 (1) – Principal Purpose Test

- Interim measure:
  - Canada included a notification under Article 7(17)(a) that while it does accept the application of PPT alone as an interim measure, it intends where possible to adopt LOB provisions in replacement of or in addition to PPT through bilateral treaty negotiations.
  - None of these provisions have been enacted to date, so PPT is currently the default treaty-based defence against treaty abuse.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 8 – One-Year Holding Period for Dividends

- Before MLI – reduced withholding rate on dividends paid to a company provided certain ownership test is met at time of dividend payment.
- No mention of how long the shares must be owned.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 8 – One-Year Holding Period for Dividends

- Changes of ownership from reorganization, e.g. mergers or divisive reorganizations are ignored in counting the 365 days.
- Note that this would apply only to treaties where both adopted this provision.
- E.g. UK has reserved for entire Article 8 not to apply meaning this provision would not apply to the Canada – UK Treaty.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 8 – One-Year Holding Period for Dividends

- Imposes a minimum 365-day holding test for shares in order to get a reduced WHT rate on dividends.
- Applies where there is an ownership, control or holding threshold required in the dividend payor.
- Test is satisfied if dividend is paid on any day of the 365-holding day period.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 8 – One-Year Holding Period for Dividends

- Ex.: Article 10(2)(a) of the Canada-Netherlands Treaty.
- PPT can still apply even if the tests in Article 8 are met.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 9 – 365-day Look Back for Certain Capital Gains

- Before MLI - Gains from disposition of shares derived their value principally from immovable property and where share ownership is less than 10% was not taxable in Canada.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Framework of PPT

- The “results test”
  - An arrangement or transaction must result, directly or indirectly, in a benefit under a CTA.
- The “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 arrangement or transaction.
- The “object and purpose test”
  - PPT does not apply if it is established that granting the benefit would be in accordance with the object and purpose of the relevant provisions of the CTA.

# MULTILATERAL INSTRUMENT (MLI)

## WHAT DOES IT ALL THIS MEAN?

### Canada – Article 9 – 365-day Look Back for Certain Capital Gains

- Also extend the same provision to treaties that do not already provide for such taxation on disposition of gains and comparable interests (e.g. partnership and trusts).
- UK has reserved for this Article not to apply.



# PRINCIPAL PURPOSE TEST (PPT)

# Framework of PPT

- The “results test”
  - An arrangement or transaction must result, directly or indirectly, in a benefit under a CTA
- The “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 arrangement or transaction
- The “object and purpose test”
  - PPT does not apply if it is established that granting the benefit would be in accordance with the object and purpose of the relevant provisions of the CTA

# The “Results” Test

- No definition of “benefit” in MLI
- Commentary to 2017 OECD model treaty:
  - “Benefit” includes all limitations (e.g. tax reduction, exemption, deferral or refund) on source taxation, relief from double taxation provided under Article 23, the protection afforded under Article 24 and similar limitations under the treaty
  - Benefit seems to compare the amount of tax determined under the treaty and under domestic law of the state levying the tax (not whether the result is more favorable compared to another treaty)
  - Not relevant that there may be relief in the other state (i.e. FTC)
- Potential reliance of courts on a broad definition of “benefit” in article 245(1) ITA
- “Directly or indirectly” appears to target situations where the transaction undertaken for the principal purpose of obtaining a benefit is not the same as the transaction in respect of which a benefit is claimed

# The “Results” Test

- No definition of “transaction or arrangement” in MLI
- 2017 OECD Commentary:
  - The terms “arrangement or transaction” should be interpreted broadly and include *any agreement, understanding, scheme, transaction or series of transactions whether or not they are legally enforceable* . In particular, they include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, 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 including steps that persons may take themselves in order to establish residence. *An example of an “arrangement” would be where steps 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. One transaction alone may result in a benefit, or it may operate in conjunction with a more elaborate series of transactions that together result in the benefit* . In both cases the provision of paragraph 9 may apply.
- Broadly similar to the definition of “avoidance transaction” in s 245(1) ITA
- Should the domestic concept of a “series of transactions” be relevant for interpreting PPT?

# The “Purpose” Test

- Objective test based on factual determination
- If the arrangement or transaction can only be reasonably explained by the benefit, then principal purpose is presumed (2017 OECD Commentary)
- “One of the principal purposes” - obtaining benefit need not be the sole or dominant purpose
- Relatively low threshold compared to GAAR (the “principal purpose”)

# The “Object and Purpose” Test

- Saving provision
- Burden of proof is on the taxpayer to establish that accessing a particular benefit is in accordance with the object and purpose of the relevant provisions
- The examination of object and purpose is directed at the relevant provisions of the CTA as opposed to the treaty as a whole
- How will the MLI preamble be incorporated into the analysis?

# Comparison of PPT and GAAR

	GAAR	PPT
Scope	<ul style="list-style-type: none"> <li>Single purpose test</li> <li>Applies <u>unless</u> the transaction was arranged primarily for bona fide purposes other than to obtain a tax benefit</li> </ul>	Applies if “one of the principal purposes of the arrangement or transaction” is to obtain a treaty benefit
Taxpayer's Intent	Onus on the tax authority	Onus on the taxpayer
Definitions	Tax benefit, transaction, and series of transactions defined	Benefit, arrangement, and transaction not defined
Object and Purpose Test	Applies <u>if</u> the transaction would result in a misuse of the provisions in the Act, other relevant enactments or a tax treaty, or abuse when those provisions are read as a whole	Applies <u>unless</u> granting the benefit would be in accordance with the object and purpose of the relevant provisions of the treaty
Application	The tax consequences shall be determined as is reasonable in the circumstances	The benefit shall not be granted

# Interaction of PPT and GAAR

- Which one takes priority?
  - GAAR applies first (Arnold)
  - PPT applies first (Department of Finance)



# Interaction of PPT and SAARs

- PPT applies in addition to SAARs (2017 OECD Commentary)
- PPT fills the gap for SAARs in respect of which Canada made a reservation

# Interpretation of PPT

- Preamble
  - MLI Preamble
  - Art. 6 preamble in CTAs
- MLI Article 2(2)
- Article 3(2) in CTAs
- OECD BEPS Materials and Commentary to OECD Model
- Paragraph 12 of Explanatory Statement to MLI

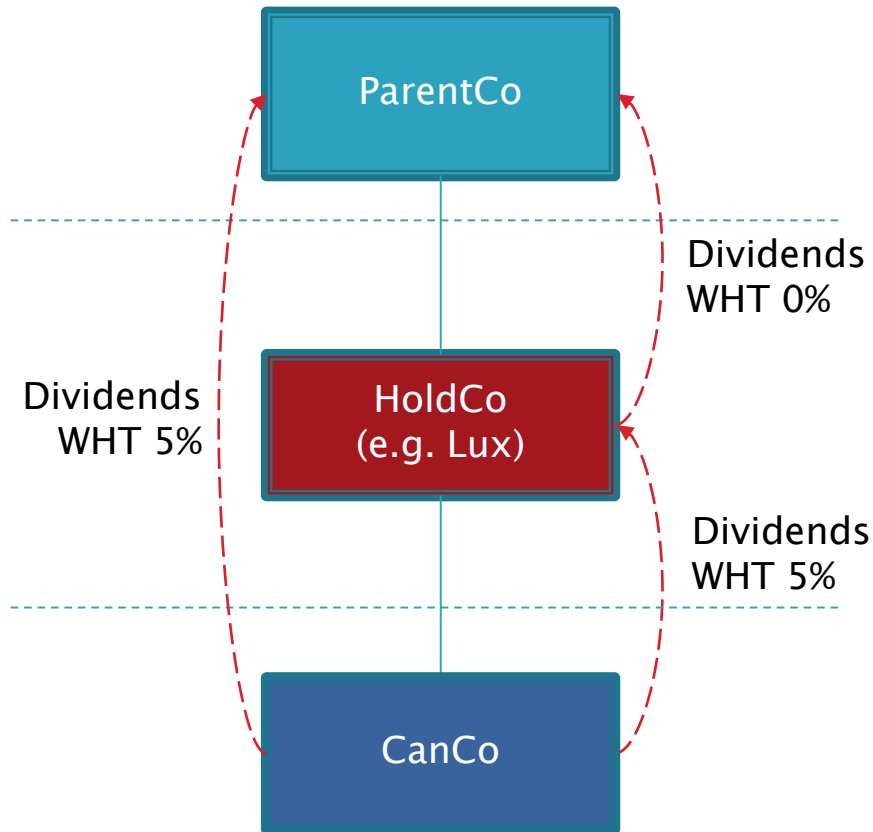
# Discretionary Relief

- Discretionary relief in Article 7(4):
  - The benefit denied under the PPT or another benefit can be granted by a competent authority on application by the taxpayer where such benefit would have been available in the absence of the transaction or arrangement
- Canada did not include this provision into the ratification process, so no possibility for discretionary relief under Canada's CTA

# IMPACT OF PPT ON CANADIAN INBOUND PLANNING

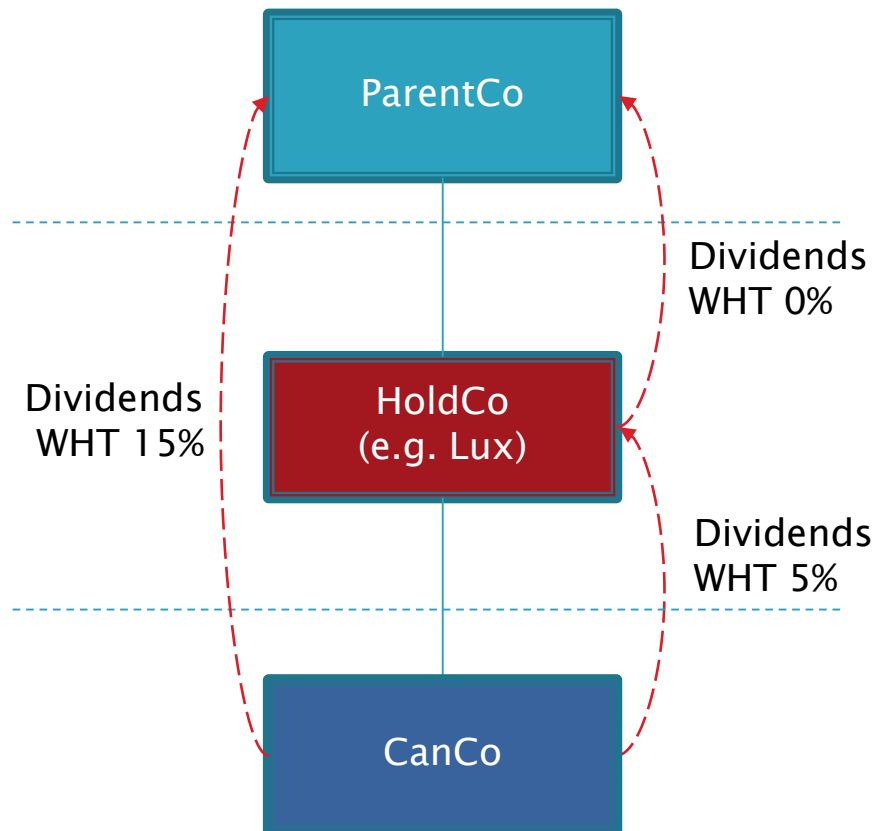
## EXAMPLE 1

Treaty benefits available to foreign intermediary are no better than those available to foreign parent



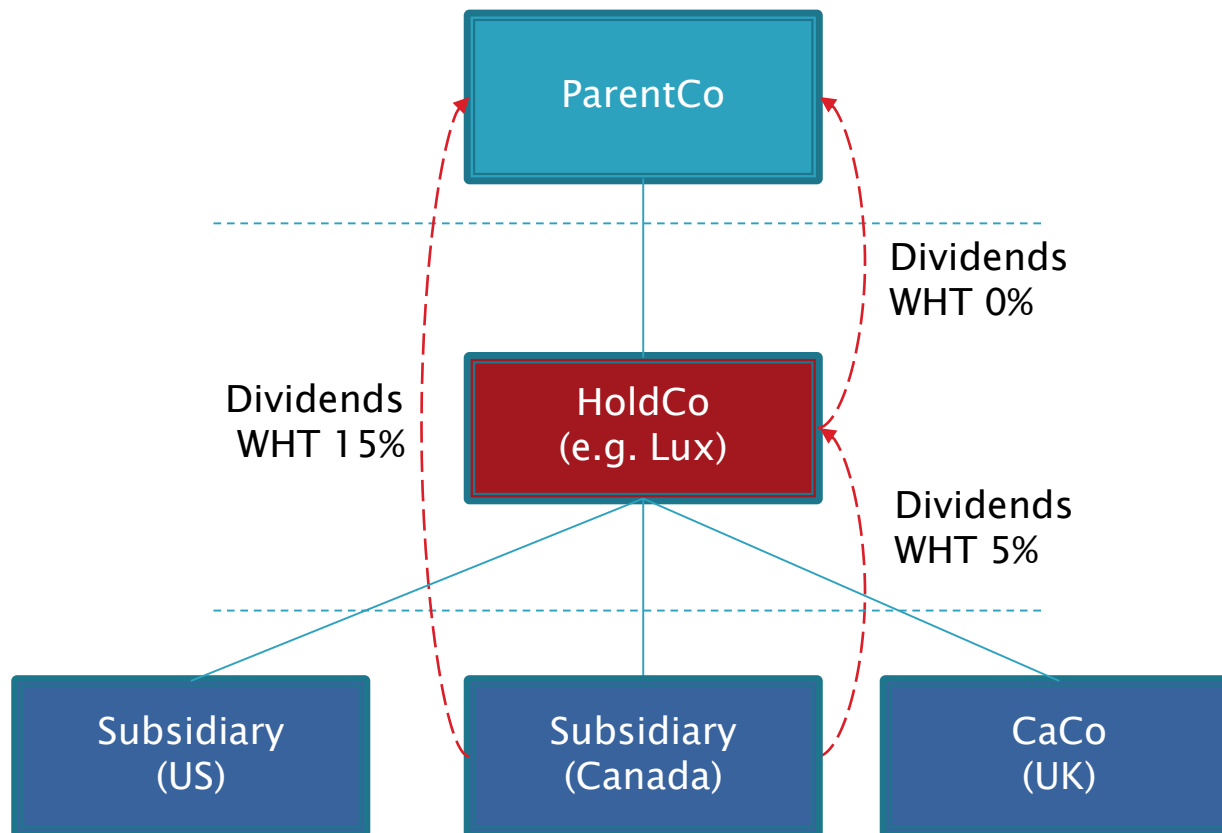
## EXAMPLE 2

Treaty benefits available to foreign intermediary are more favorable than those available to foreign parent



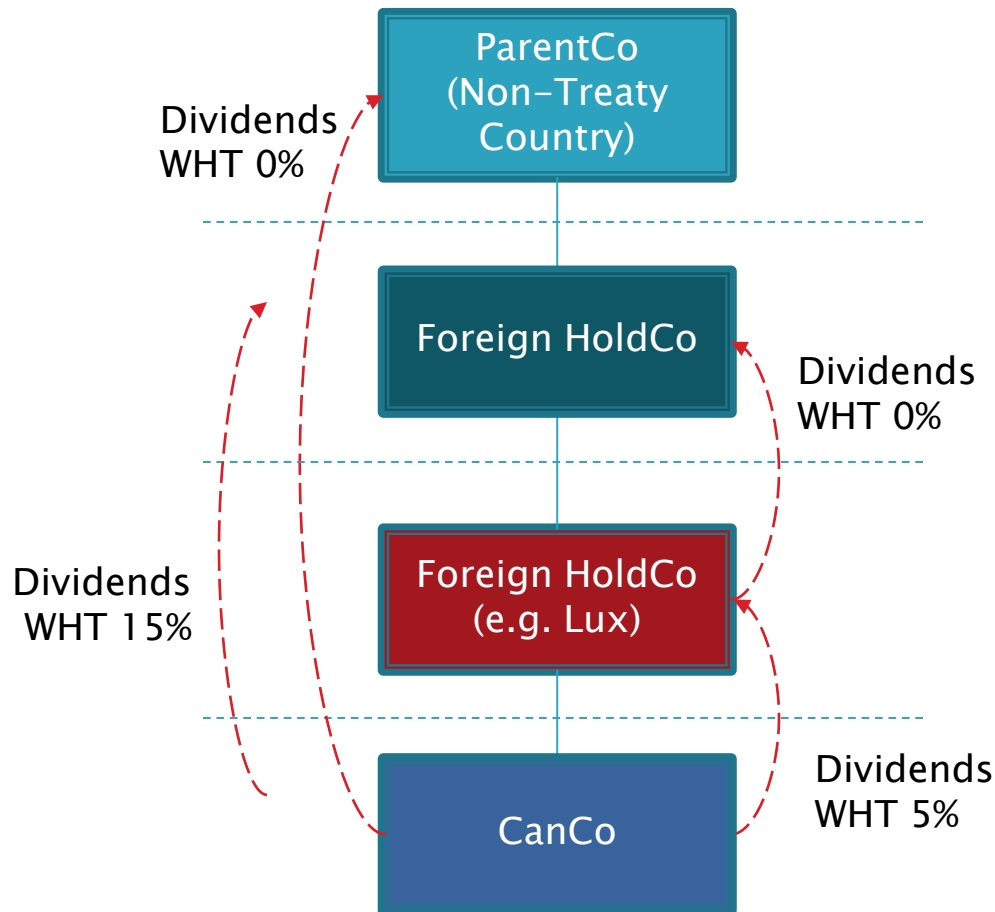
## EXAMPLE 3

Treaty benefits available to foreign intermediary are more favorable than those available to foreign parent and the intermediary performs a business function



## EXAMPLE 4

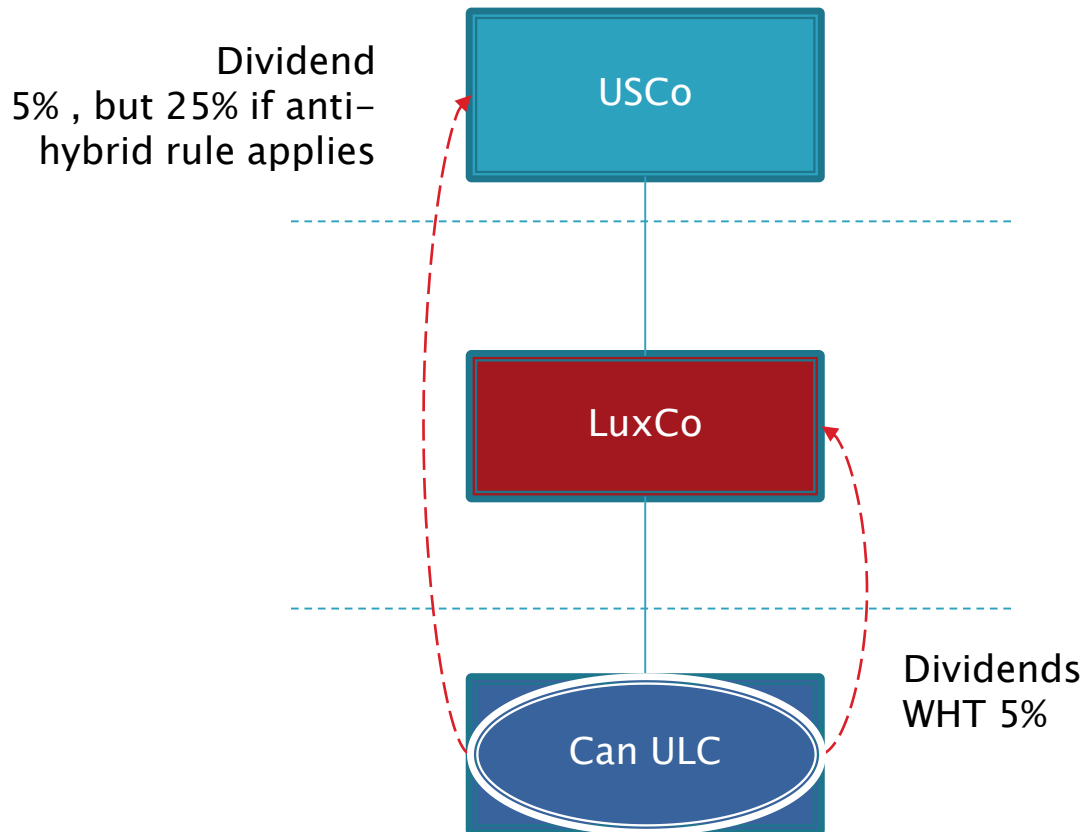
Treaty benefits available to some foreign intermediaries but not others, and none available to foreign parent





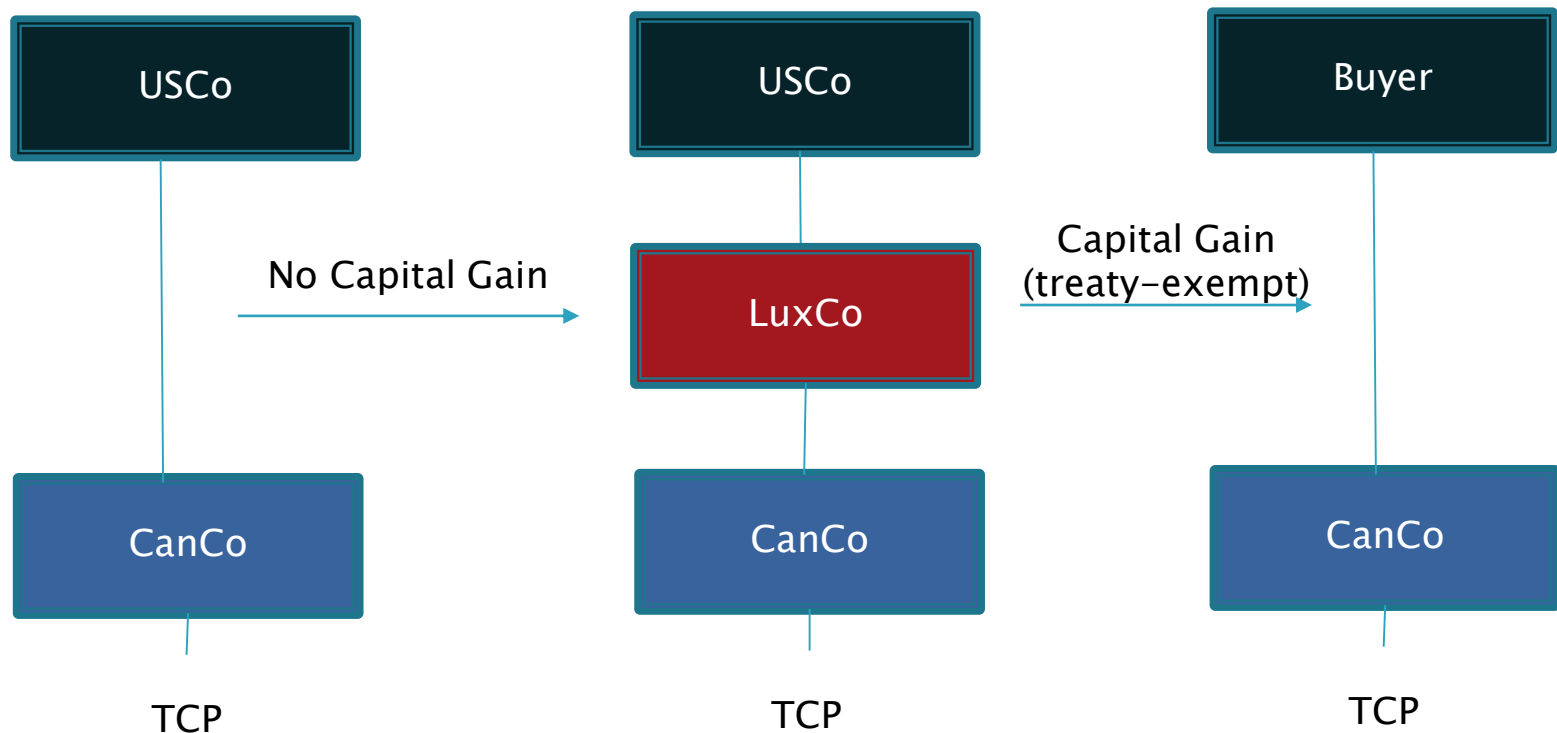
## EXAMPLE 5

Treaty benefits available to foreign intermediary no better than foreign parent except no anti-hybrid rules (which are unique to Canada-US Treaty)



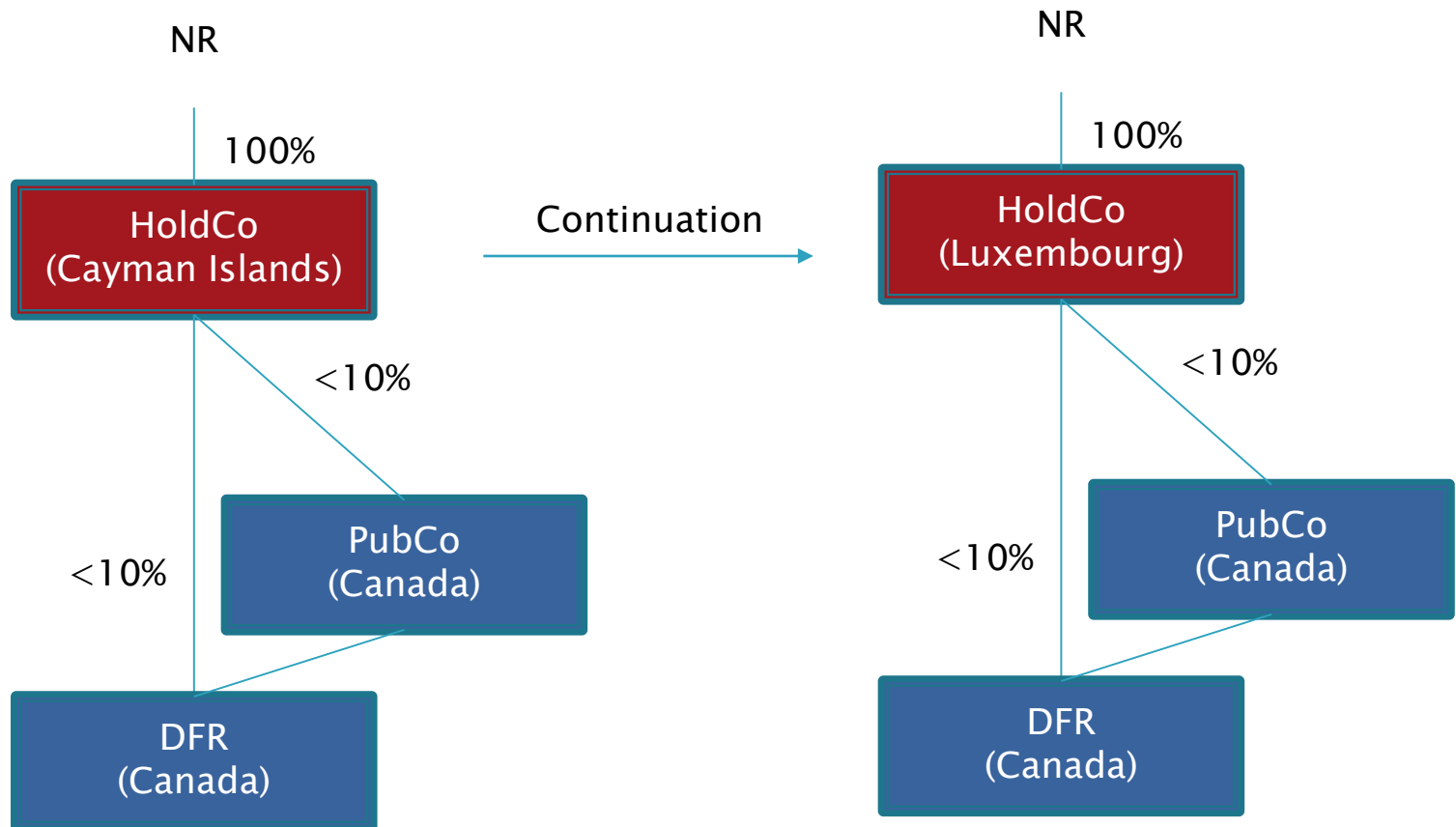
## EXAMPLE 5

### Incremental treaty benefits available to intermediary under treaty with respect to TCP



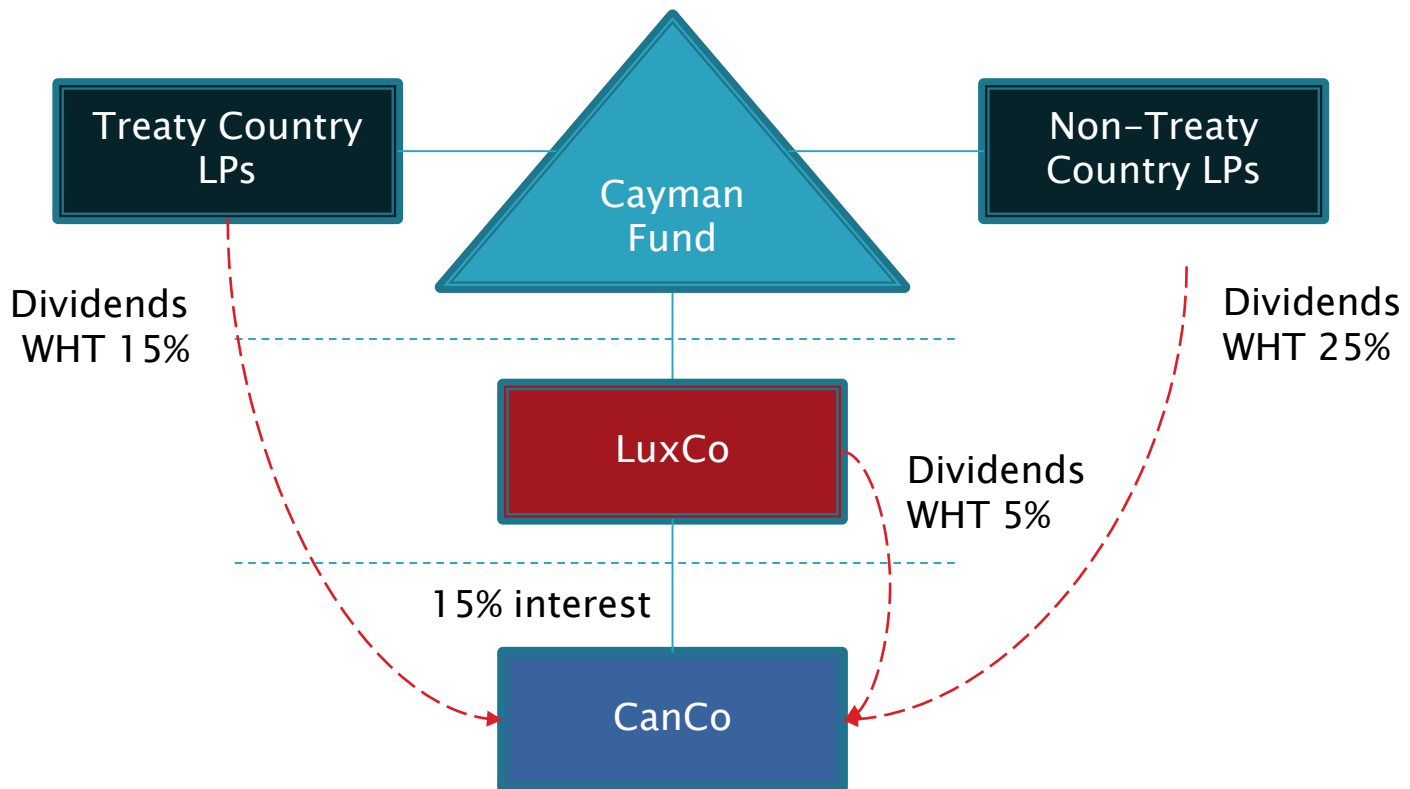
## EXAMPLE 6

### Incremental treaty benefits available to intermediary under treaty with respect to TCP



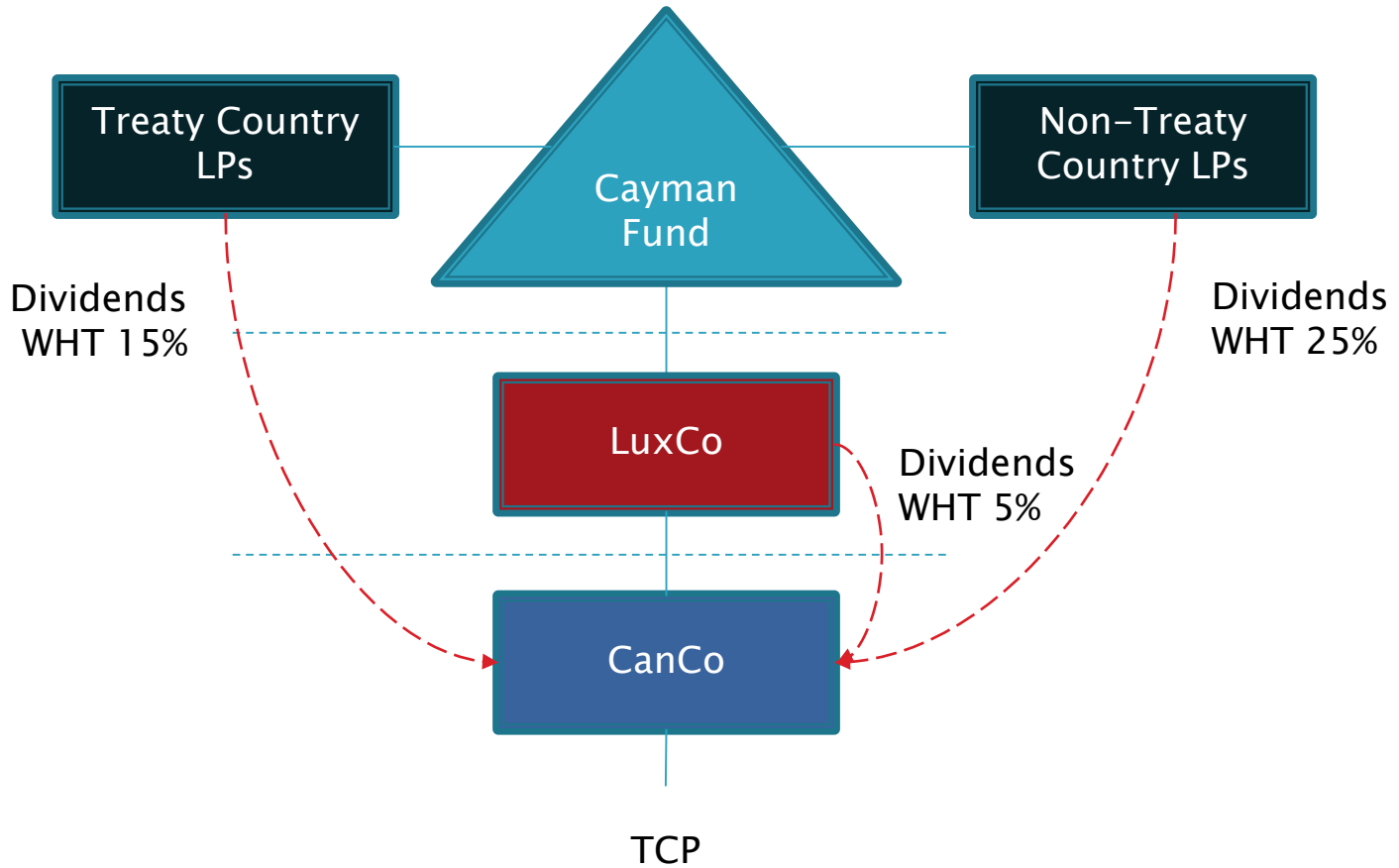
## EXAMPLE 7

Treaty benefits available to the intermediary are better than treaty benefits available to LPs



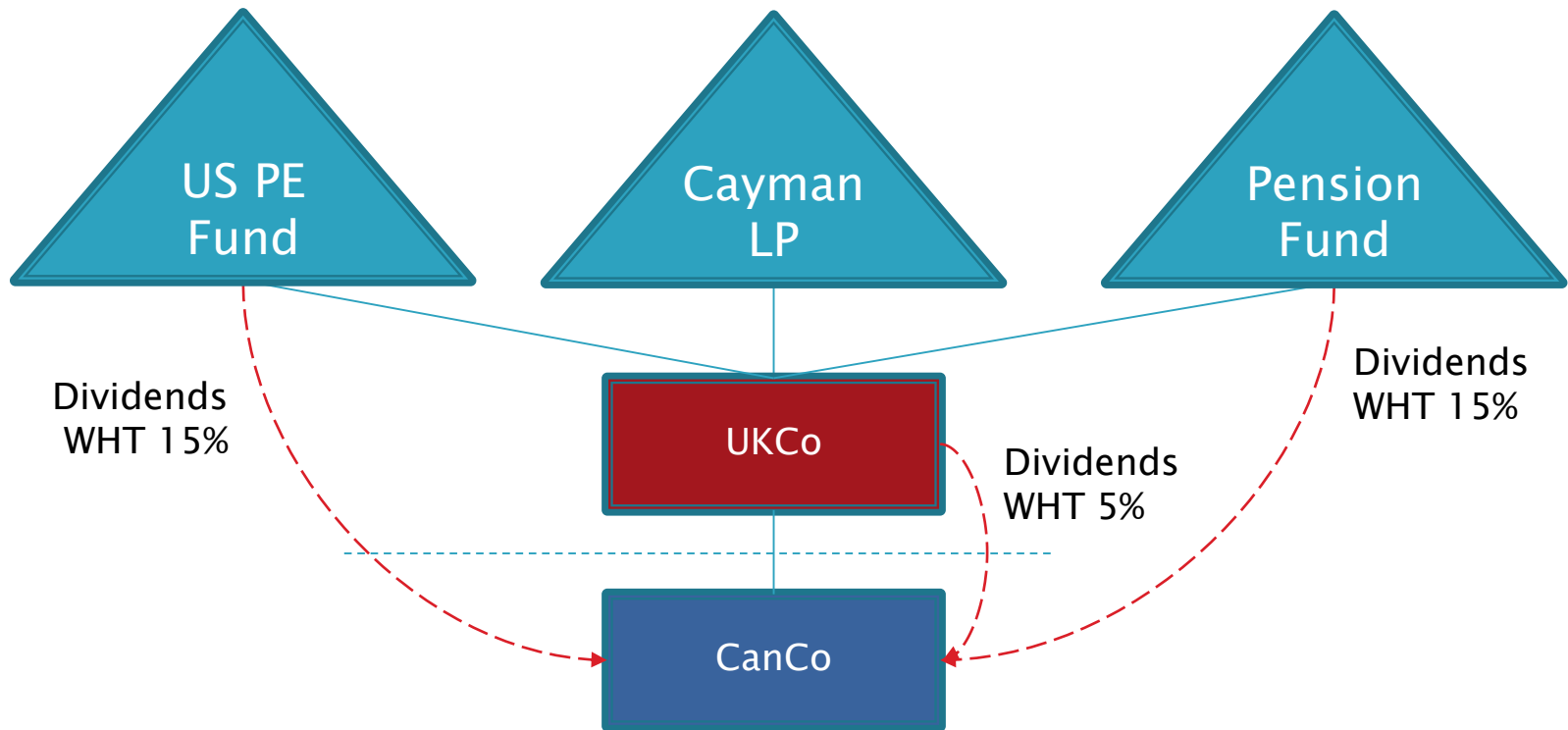
### EXAMPLE 8

## Several sources of differential treaty benefits



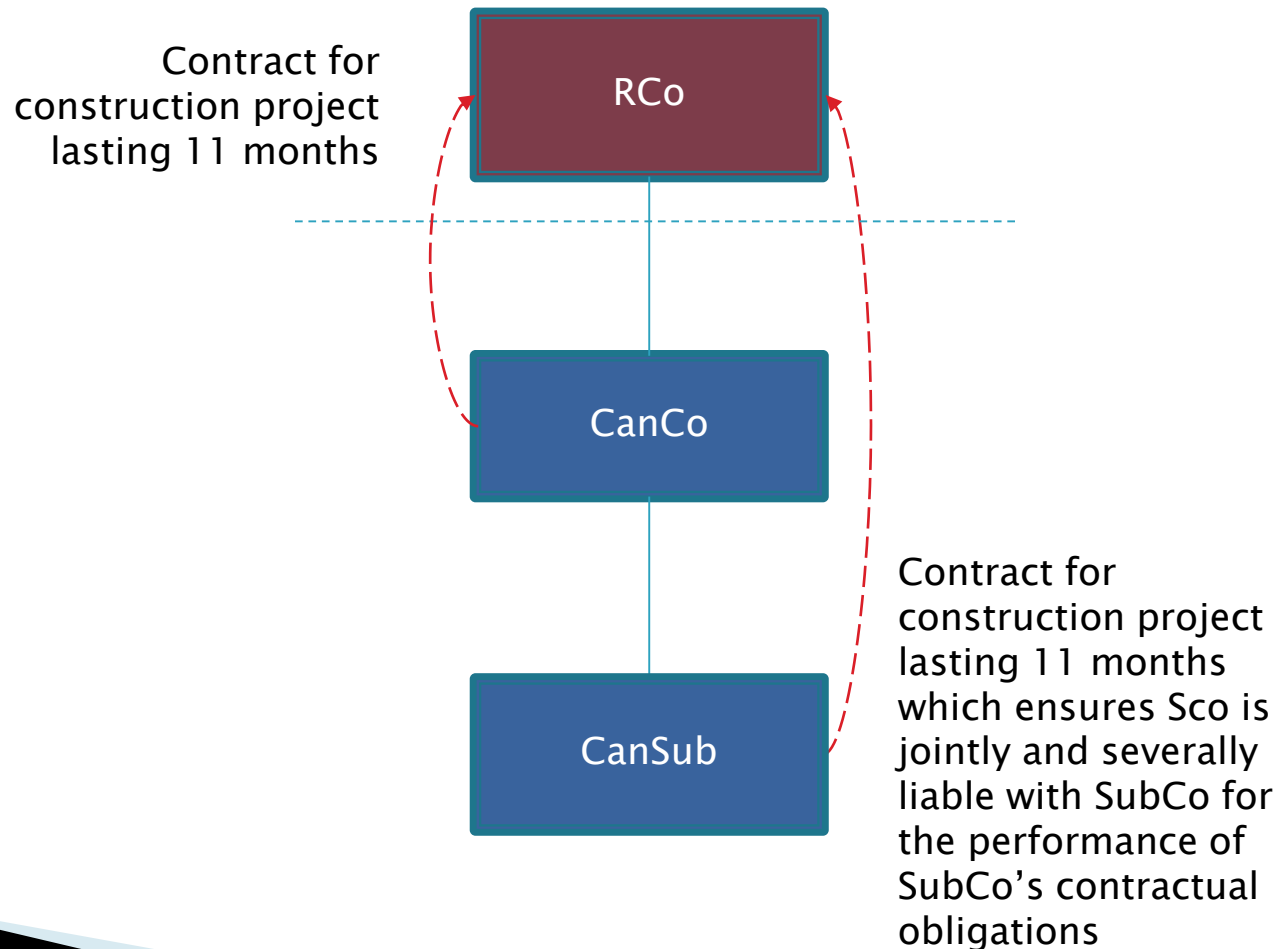
## EXAMPLE 9

Same example as 5 except multiple institutional investors all agreeing to a common HoldCo



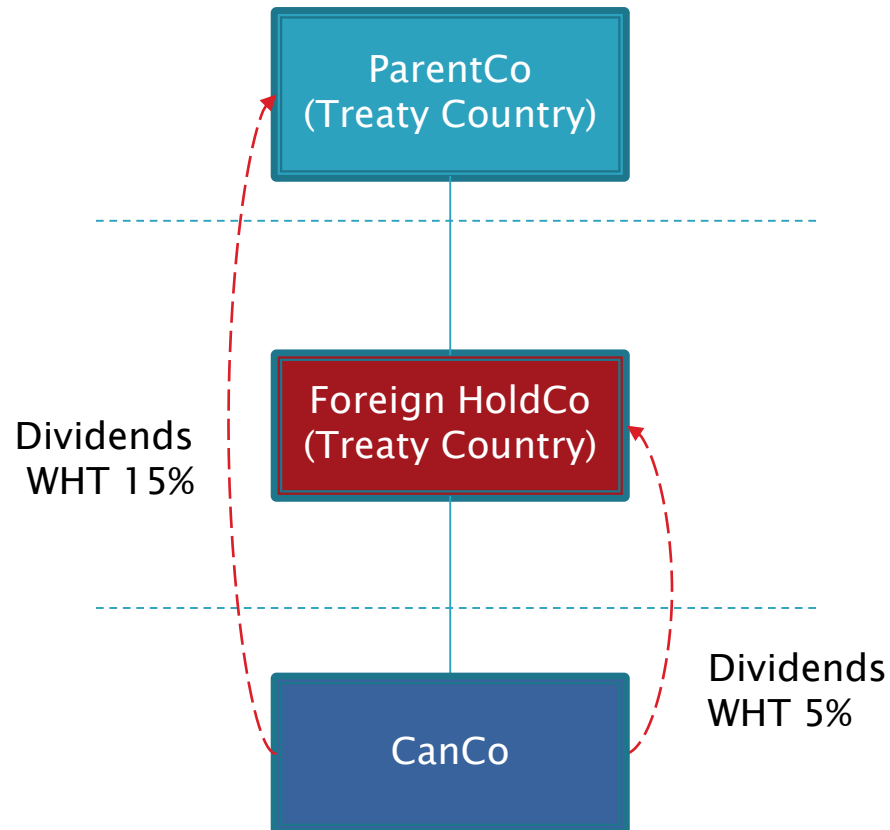
# EXAMPLE 10

## Permanent Establishment



# EXAMPLE 11

## Non-Availability of Discretionary Relief





# Minimizing PPT Exposure

- Sufficient substance
- Use of passthrough vehicles
- Preserve or step-up adjusted cost base

# Matters Regarding Administration of PPT

- Additional guidance (e.g. Folio or IC)?
- Tax audits
- Advance tax rulings
- MLI committee
- How to achieve global consistency
- Payments to arm's length parties
- Dispute resolution – exclusion of GAAR/PPT from mandatory arbitration