Kluwer International Tax Blog

BO Bites Husky, GAAR Remains Toothless – Part I. International treaty autonomous BO-GAAR relationship

B?a?ej Ku?niacki (PwC Netherlands, Lazarski University and Singapore Management University) · Monday, April 22nd, 2024

Part I. International treaty autonomous BO-GAAR relationship

"[T]he concept of beneficial ownership is a basic principle of income taxation: the beneficial owner of income is the person who should be taxed on the income. [(…)] The concept of beneficial ownership is not a good anti-avoidance rule for dealing with conduit and other tax avoidance arrangements. The temptation for desperate tax authorities to use (misuse) any weapon at their disposal to combat tax avoidance should be resisted. Other specific and general anti-avoidance rules in both domestic law and tax treaties are better suited for this purpose." – Brian J. Arnold, 'International – Tax Treaty News' (2010) Bulletin for International Taxation, p. 308.

I would like to give thanks to Professor Allison Christians for discussing and reviewing the early draft of this post.

1. Introduction

This blog will start with a premise which, perhaps too laconically, summarises the fundamental conclusion I have derived from my research of the concept of beneficial ownership (BO) in international taxation: the function of BO is to allocate income more than it is to prevent abuse. As such, the concept of BO is redundant, paradoxical and can even be harmful. Thus, with the principal purposes test (PPT) and the general anti-avoidance rule (GAAR) in force,[1] it would be a wise and brave tax policy decision to remove the concept of BO from tax treaties, the OECD and UN Model Tax Conventions (MTCs), and the EU Interest & Royalty Directive. The road to reach this conclusion has been a long one. Those wishing to dive deeply into the analysis behind that conclusion may refer to a number of articles (see e.g. here) and the two books (see here & here) I have published recently on this exciting and highly relevant topic for tax scholars and practitioners alike.

In my work, I have praised the Canadian courts for effective judicial transplant of the international tax language of BO for domestic tax law purposes. They not only cite but also faithfully follow the OECD documentation and the rules and principles of interpretation under the Vienna Convention

on the Law of Treaties (VCLT) in order to discern the proper meaning of treaty concepts.

Notably, an effective judicial transplant of BO is the landmark *Prévost Car* case. In that case, the Tax Court of Canada (TCC, Associate Chief Justice Rip) in a judgment of 22 April 2008 – fully upheld by the Federal Court of Appeal (FCA) in its judgment of 17 February 2009 – cited and duly followed passages from the 1977 and 2003 versions of the OECD Commentary to Art. 10 and the 1986 OECD Conduit Companies Report to decode the meaning of the BO of dividends. The case did so in a narrow legal way, closely in line with the view of BO as a rule of income allocation.[2] Justice Rip's reasoning was largely in accordance with the VCLT. This Canadian jurisprudence contributes to international convergence in the understanding and application of the concept of BO.

The otherwise impeccable reputation of the Canadian case law on BO is potentially strained with the judgment of the TCC (Justice John R. Owen) of 13 December 2023 in *Husky Energy Inc. v. The King* case (hereinafter *Husky Energy*). This judgment sparked a spirited discourse among Canadian tax experts, who variously characterized Justice Owen's analysis as "disappointing", "fundamentally wrong", and "shocking" (Kandev), "puzzling" (Christians), and possibly leading to "nonsensical" results (Nikolakakis).

This post is one of two that focus on the relation between the GAAR (or the PPT) and the concept of BO from two perspectives: (i) as a purely international and autonomous concept and (ii) in the sense arising out of the *Husky Energy* case. In respect of the latter, Jonathan Schwarz posted a nice summary here. Part I presents and analyses the relation between the concept of BO and GAAR, which is equally relevant to all anti-tax avoidance measures, including the PPT and the judicial doctrines, purely from the perspective that BO is an autonomous tax treaty concept. Part I will also address the evolving relationship between the Canadian GAAR and the concept of BO under Canada's tax treaties. Part II will focus more on the *Husky Energy* case in light of the observations made in this Part.

2. The microscopic role of anti-abuse in the autonomous treaty-based concept of BO

The relationship between the concept of BO. on the one hand. and treaty and domestic anti-abuse measures. on the other, is explained in para. 12. 5 of the Commentary on Art. 10 of the 2017 OECD MTC as follows:

The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 22 below). The provisions of Article 29 [the LOB & the PPT] and the principles put forward in the section on "Improper use of the Convention" in the Commentary on Article 1 will apply to prevent abuses, including treaty-shopping situations where the recipient is the beneficial owner of the dividends. *Whilst the concept of "beneficial owner" deals with 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),* **it does not deal with other cases of abuses, such as certain forms of treaty shopping**, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

(emphasis added)

This part of the Commentary refers to the relationship between the concept of BO and the specific and general anti-abuse provisions in treaties (e.g. the PPT in Art. 29(9) and the LOB in Art. 29(1)-(8) of the 2017 OECD MTC) as well as the various types of domestic antiabusive rules and doctrines, such as GAARs and substance-over-form or economic substance approaches (doctrines).[3] It sets the order and the scope of application of these provisions.

In principle, the concept of BO applies first.[4] Hence, even if, after applying the concept of BO, the direct recipients of the income are found to be the BOs thereof, the benefits under Art. 10, 11 and 12 may still be denied by means of treaty[5] or domestic anti-abuse measures.[6]

The Commentary further indicates that the concept of BO has a very narrow anti-abuse function, if indeed its function is about abuse at all, as it only applies to forms of tax avoidance that involve "the interposition of a recipient who is obliged to pass on the dividend to someone else." OECD Commentary explains that this means interposed entities that are subject to a contractual or legal obligation to pay the income to another (para. 12.4 of the Commentary on Art. 10 of the 2017 OECD MTC). This explanation will be discussed in more detail in Part II of this post. Read narrowly to target mainly agency or nominee relationships or close proxies thereto, abusive treaty shopping falls outside the scope of application of the concept of BO. This observation of the OECD is then linked with the conclusion that the concept of BO "must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases." In other words, the concept of BO must not be 'stretched' to cover abusive treaty shopping cases that are targeted by 'specific anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches,' as this practice could restrict (or at least confuse) the application of such measures.

This observation demonstrates, contrary to the views of some scholars (e.g. Danon, sec. 15.2.5.3) that in the quoted part of the Commentary the OECD is indicating that the substance-over-form approach and economic substance analysis are not part of the examination under the concept of BO. Instead, these anti-abuse approaches belong to two distinct group of legal measures that should be applied separately and sequentially (following the order mentioned above). This interpretation is, moreover, supported by the structure of the quoted passage of the Commentary. It first says that abusive treaty shopping situations with the use of conduits are addressed *in many ways*.[7] Then it says that these many ways 'include specific anti-abuse provisions in treaties, general anti-abuse rules and *substance-over-form or economic substance approaches.*' The sentence immediately following begins with '*Whilst* the concept of "beneficial owner" deals with…' which implies that the concept of BO is contrasted with substance-over-form or economic substance approaches, rather than merged with them.[8]

If the OECD had considered the concept of BO to be a broad anti-abuse measure, then once it was determined that the direct recipient of the income (the interposed entity) is the BO thereof, other

treaty or domestic anti-abuse measures could be applied by the tax authorities to deny tax treaty benefits *only beyond* the scope of the already applied concept of BO. This would significantly reduce the scope of application of domestic GAARs (e.g. that of Canada), treaty GAARs (e.g. the PPT), and SAARs, as well as judicial anti-abuse doctrines such as the mentioned substance-over-form or economic substance approaches. Such an interpretation would be blatantly at odds with the wording of the Commentary as analysed above, as well as the current policy of the OECD, which is manifested in the variety of anti-abuse measures added to the 2017 OECD MTC even as the concept of BO remained explicitly unmodified. Implicitly, however, the anti-abuse function is now effectively microscopic.

Many OECD examples illustrating how the PPT should operate mirror high-profile cases on the concept of BO decided by various courts several years ago. A good illustration is seen in Example A in para. 182 of the Commentary on Art. 29(9) of the 2017 OECD MTC. The facts summarized in that example appear to be taken directly from the *Royal Dutch* case, commonly referred also to as 'The First Market Maker case', decided by the Dutch Supreme Court (*Hoge Raad*) on 6 April 1994.[9] Example B, in turn, as depicted in the same part of the Commentary, seems to be inspired by the *Royal Bank of Scotland* case decided by the French Supreme Administrative Court (*Conseil d'État*) on 29 December 2006[10] (see also Van Weeghel, pp. 31-32). These examples suggest that the OECD needed to consider the concept of BO to be extremely narrow and applying basically only to agents and nominees (Van Weeghel, pp. 31-41). Thus, the anti-abusive role of the concept of BO seemed to be so marginal that the OECD did not devote a single word to that concept while analysing the hypothetical operation of the PPT.

The in-depth research of mine on that theme (see here, sec. 3.XII) reveals that, in addition to agents and nominees, the anti-abusive potential of the concept of BO may arise towards conduit entities in extremely obvious situations where such entities have almost no actual power over the income received, usually functioning in isolation from real transactions (sham or simulated transactions).[11] In such situations, however, neither the concept of BO nor the PPT are necessarily needed to counter such conduit arrangements or transactions so long as courts do not take an inappropriately strict approach in the interpretation of tax treaties. Ordinary rules of evidence, in conjunction with the canons of legal interpretation relevant to tax treaties, are sufficient for tax consequences not to be drawn from transactions that were sham or simulated so that, as a result, their legal documentation is not reflected in reality. Consequently, no treaty benefits should be granted to taxpayers involved in such arrangements or transactions. Such an approach can be found in tax jurisprudence in cases regarding patently abusive arrangements and transactions, including round tripping.[12] This all means that the concept of BO, as of 2017, remains operative for potential abusive practices only towards agents and nominees, and conduits acting in functionally the same manner as agents and nominees. It is a concept intended to clarify the allocation of income to the taxpayer rather than a narrowly applied anti-abuse rule. The addition of the PPT to the 2017 OECD MTC and tax treaties, under MLI or bilaterally, considerably strengthens this interpretation and the observations stemming from it.

3. The relation between the Canadian GAAR and the concept of BO under

tax treaties

The observations from section 2 above are of relevance to the relation between the concept of BO and the domestic GAAR, such as the Canadian GAAR, even before the anti-abuse changes in the 2017 OECD MTC were made.

As early as in 1977, paras 7-9 of the Commentary to Art. 1 0f the OECD MTC indicated that

The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons; **they should not**, however, **help tax avoidance** or evasion. (…)

Moreover, the extension of the network of double taxation conventions still reinforces the impact of such manoeuvres as they make it possible, **through the creation of usually artificial legal constructions**, to benefit both from the tax advantages available under certain domestic laws and the reliefs from tax provided for in double taxation conventions

This would be the case, for example, *if a person* (whether or not a resident of a Contracting State), *acted through a legal entity created in a State essentially to obtain treaty benefits which would not be available directly to such person*. (…) (the emphasis added)

Thus, from the early stage of international tax law, the OECD was aware that, to use the words of Brian J. Arnold (p. 10), '[j]ust as double taxation imposes an inappropriate barrier to international commerce, the tolerance of fiscal evasion and avoidance offers an inappropriate incentive to such commerce.'

In 2003, in addition to an explicit statement that the purpose of tax treaties is also to prevent tax avoidance (para. 7), the Commentary on Art. 1 of the OECD MTC stated that domestic anti-avoidance rules such as GAARs are not precluded by tax treaties to prevent abusive tax avoidance (paras 8-9.5 and 22.1). In para. 9.5, the OECD has also outlined a framework – *a guiding principle* -– for such prevention in a treaty-compatible way:

A guiding principle is that the benefits of a double taxation convention should not be available *where the main purpose for entering into certain transactions or arrangements was 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*. (the emphasis added)

In 2017, the OECD said that the PPT 'mirrors' a guiding principle,[13] although there are justified doubts that the PPT and a guiding principle are identical. They are not, because the PPT operates more in favor of tax authorities than a guiding principle does. The PPT imposes the burden to establish its second prong (abuse) on taxpayers and it refers to 'one of the principal purposes' instead of 'the main purpose' in respect of its first prong (tax avoidance). This purpose is to be demonstrated at the outset by the tax authorities (Van Weeghel, p. 14; Ku?niacki, pp. 249-250):

Notwithstanding the other provisions of this Convention, a benefit under this Convention 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 this Convention. (emphasis added)

As aptly stated by Stef van Weeghel,

the difficulty that tax authorities had in the past with demonstrating that granting the tax treaty benefits would be contrary to the object and purpose of the tax treaty now becomes the difficulty of the taxpayer to demonstrate that granting a benefit would be in accordance with the object and purpose of "the relevant provisions of this Convention".

In comparing the Canadian GAAR and the PPT, Jonathan Schwarz pointed out that both rules comprise three elements:

(1) there must be a ""tax benefit"(GAAR)/ treaty benefit (PPT);

(2) the transaction must be an "avoidance transaction", meaning one that is not undertaken primarily for a bona fide non-tax purpose (GAAR)/ the one of the principal purposes of the arrangements giving rise to the benefit must be obtaining that benefit (PPT); and

(3) the avoidance transaction giving rise to the tax benefit must be an "abuse".

He then correctly observed that the second element of the Canadian GAAR contains a higher threshold ("primarily"" for a bona fide non-tax purpose) than the PPT requirement ("one of" the principal purposes). I would also add that the Canadian GAAR has a higher threshold than the PPT to identify and prevent abusive tax avoidance because of its abusive element: Only the GAAR from the very beginning puts the burden to establish its abusive element on the tax authorities whereas the PPT puts it on the taxpayers (cf. the above citation from the article of Van Weeghel).

Accordingly, the Canadian GAAR is harder for the tax authorities to apply in preventing abusive treaty shopping than the international standard to do so, i.e. the PPT, as implemented via the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) by more than 100 States around the globe.[14] Still, the relation between the concept of BO and GAARs/the PPT (section 2 above) shows that outside of determining who the proper taxpayer is by virtue of the status of an intermediary as an agent or nominee, or a conduit acting in the same manner as an agent or nominee[15], it is the Canadian GAAR, and not the concept of BO, that should be applied to target abusive treaty shopping in respect to arrangements and transactions that took place in 2003. That is, however, not how Justice Owen seems to have understood the relation between the concept of BO and the Canadian GAAR as he expressed it in the *Husky Energy* case. I will address it in the next Part II of this post. It will demonstrate that while BO bites Husky, leaving deadly wounds, the Canadian GAAR remains toothless.

[1] Or, depending on the legal system, a judicial anti-abusive doctrine such as substance over form,

economic substance, sham, business purpose, step-transaction, abuse of law and *fraus legis*. See para. 78 of the Commentary on Art. 1 of the 2017 OECD MTC. Whenever in this post a reference is made to denial of tax treaty benefits via a GAAR or the PPT, it may be, *mutatis mutandis*, valid for purposes of doing so by a doctrine mentioned above, or any similar doctrine.

[2] Carlo Garbarino noted that the Canadian tax jurisprudence is overall rich of effective judicial transplants from the Commentaries and other OECD interpretative materials. For other cases see, for example: Canada, Tax Court of Canada, judgment, 28 September 2007, *Garcia v. Her Majesty the Queen*, [2008] 1 C.T.C. 2215; Canada, Supreme Court of Canada, judgment, 22 June 1995, *Crown Forest Industries Ltd. v. Her Majesty the Queen*, [1995] 2 C.T.C. 64. 29; Canada, judgment, 16 May 2008, Tax Court of Canada, *Knights of Columbus v. Her Majesty the Queen*, 2008 TCC 307; Canada, Tax Court of Canada, American Life Insurance Co. v. Her Majesty the Queen, 16 May 2008, 2008 TCC 306. Cited after: C. Garbarino, *Judicial Interpretation of Tax Treaties: The Use of the OECD Commentary*, (2016) Edward Elgar Publishing, paras. 1.32–1.34, 10-11.

[3] *See* 'Improper use of the Convention' in paras. 54-80 of the Commentary on Art. 1 of the 2017 OECD MTC.

[4] This principle does not apply to the relations between the LOB clause and the concept of BO insofar as the former applies before the latter, i.e. it applies together with or just after a determination of the 'resident of a Contracting State'.

The purpose of the tests under the LOB clause is to raise the threshold in respect of the subjective scope of tax treaties (i.e. Arts 1, 3 and 4(1) of the OECD Model) by giving access to treaty benefits only to taxpayers who, in addition to being residents of a contracting state, either have a sufficient personal and economic nexus to their resident State (the qualified persons' test), or carry out real business activities in their resident State (the active business test), or are not driven by abusive treaty shopping motives (the derivative test and the residual bona fide test under the discretionary benefits provision). Cf. para. 6 of the Commentary on Art. 29 of the 2017 OECD MTC. *See* more: B. Ku?niacki, 'Implementation and Application of the LOB Clause in BEPS Action 6/MLI: Legal and Pragmatic Challenges' in: Dourado, Ana Paula, eds., International and EU Tax Multilateralism: Challenges Raised by the MLI (2020) IBFD, pp. 270-291.

[5] It is therefore assumed that the tax treaty between the source State of the income and the resident State of its direct recipient includes the relevant anti-abuse measures, such as the PPT.

[6] In conjunction with, or alternatively to the assumption mentioned in the footnote immediately above, it is assumed that the source State of the income and/or the resident State of its recipient has in force domestic antiabusive measures such as GAARs or/and antiabusive doctrines, e.g., and substance-over-form or economic substance doctrines.

[7] See also González-Barreda, p. 256: 'The fact that subparagraph 12.6 (of the Commentary to the dividends article) distinguishes beneficial ownership from substance over form GAARs also confirms this. It would be unwise to state that beneficial ownership does not preclude the use of substance over form GAARs if they mean the same.' (footnote omitted).

[8] The word 'whilst' is a conjunction that, according to the Oxford Dictionary, is used to contrast two things. https://www.oxfordlearnersdictionaries.com/definition/english/whilst?q=whilst.

[9] The Netherlands: *Hoge Raad*, Judgment, 6 April 1994, case no. 28.638, BNB 1994/217.

[10] France: *Conseil d'État* (The French Supreme Administrative Court), judgment, 29 Dec.2006, *Ministre de l'Economie, des Finances et de l'Industrie v. Société Bank of Scotland*, No. 283314, 9 ITLR 683 et al. See the analysis of this case *infra* sec. 5.IV. The same observation was made by: Van Weeghel, Stef 'A Deconstruction of the Principal Purposes Test' (2019) 11 *World Tax Journal*, sec. 8.

[11] Cf. A. Martín Jiménez, 'Beneficial Ownership' in: Vann, Richard et al., eds., *Global Tax Treaty Commentaries* (2020) IBFD, sec. 3.3.

[12] See, for example: India, the Supreme Court of India, Judgment, 20 January 2012, *Vodafone International Holdings BV v. Union of India*, Civil Appeal No. of 2012 (Special Leave Petition (C) No. 26529, 2010), para. 68, 14 *International Tax Law Reports*, pp. 431-451; France, *Conseil d'État* (The French Supreme Administrative Court), Judgment, 25 October 2017, Case No. 396954, *Verdannet* 20 International Tax Law Reports, pp. 832-872.

[13] *See* para. 169 of the Commentary on Art. 29 of the 2017 OECD MTC.

[14] Status as of 24 February 2024, see here.

[15] Albeit even such situations seem to be better dealt with by GAARs/PPT. *See* P. Baker, 'The Meaning of "Beneficial Ownership" as Applied to Dividends under the OECD Model Tax Convention' in: Maisto, Guglielmo, ed., *Taxation of Intercompany Dividends Under Tax Treaties and EU Law*, (2012) IBFD footnote 9 at para. 6.3.

This entry was posted on Monday, April 22nd, 2024 at 1:53 pm and is filed under Beneficial ownership, GAAR, OECD, Principal purpose test
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.