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BO Bites Husky, GAAR Remains Toothless – Part II. The (Toxic) Relationship of BO and GAAR in Light of the Husky Energy case

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Part II. The (Toxic) Relationship of *BO and GAAR in Light of the Husky Energy case.*

"[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 the post.

1. Introduction

Part I of this post set the scene by demonstrating the relation between the GAAR (or the PPT) from a purely autonomous international perspective. This Part turns to Justice Owen's perspective (Tax Court of Canada, TCC) as expressed in his judgment of 13 December 2023 in *Husky Energy Inc. v. The King* (hereinafter, the *Husky Energy* case) under the 1999 Luxembourg-Canada tax treaty (LU-CA Tax Treaty) and the 1980 Barbados-Canada tax treaty (BA-CA Tax Treaty). Justice Owen's interpretation has been characterized by tax experts as 'complex' (Schwarz) as well as 'intriguing' and 'puzzling' (Christians, p. 443).[1] Before diving into the legal analysis, I will briefly present the essential facts of that case and points laid out by Justice Owen.

2. Essential facts and points of the TCC in the *Husky Energy* case

Justice Owen examined the concept of BO in respect of dividend payments on the following facts (for the full summary of facts see paras 13-232 of the *Husky Energy* case). Three tax resident companies in Barbados (Barbcos) owned a significant percentage of shares in Husky Energy, a Canadian tax resident and public company. In August 2003, the Barbcos entered into overseas

securities lending agreements (OSLAs) with two tax resident companies in Luxembourg (Luxcos). The Barbcos and the Luxcos were either directly or indirectly owned by Hong Kong billionaire business magnate, investor, and philanthropist Li Ka-shing and a trust for the Li family. The Barbcos, as lenders, lent certain shares of Husky Energy (securities) to the Luxcos (borrowers) under the OSLAs in exchange for compensation paid and to be paid in the future by the Luxcos. The Luxcos were contractually obligated to pay what the OSLA called "manufactured dividends" (OSLA at p. 7), namely, compensation in an amount equal to 'all dividends, if any, paid on the borrowed Securities that would have been received by the Borrower if it had held the borrowed Securities' no later than the termination date of the transaction" (para. 268). Such a payment occurred approximately seven weeks after the payment of dividends to the Luxcos by Husky Energy (paras 268, 270). Justice Owen also noted that the OSLAs were entirely tax-motivated to ensure a more favourable overall tax result for the Barbcos and the Luxcos, i.e. to reduce Canadian WHT from 25% (the domestic Canadian tax rate on dividends) to 0% for the Barbcos by shifting the tax liability in Canada to the Luxcos, and thereby to reduce such WHT from 25% to 5% on the Luxcos under Art. 10(2) LU-CA Tax Treaty (see, in particular, paras 320, 329, 349-350, 366-367, and 412). Although Justice Owen examined these factual observations for purposes of undertaking an analysis of GAAR rather than BO, my earlier research demonstrates that the reasoning of judges in BO-related cases is heavily influenced by facts implying the use of intermediary entities for tax avoidance purposes (see here sec. 4.VII). In such cases, courts are generally more willing to deny treaty benefits to intermediary entities in order to prevent treaty shopping.

3. BO equals to a taxpayer of income paid from the source State: BO as a connecting thread between "dividends paid to" and "dividends allocated to" a taxpayer

In accordance with the origin of the concept of BO, in my previous research (see the research behind it here & here), I contended that an autonomous treaty meaning of the concept of BO equates BO with the person to which relevant income (here: dividend income) is actually (rather than in a simulated way) attributed by a relevant Contracting State or both Contracting States to a taxpayer (typically but not always a direct recipient of dividends). Following the findings of my research, I generally argue that this allocation approach should be a point of a departure to determine BO, which may—and in most cases should—lead to a final determination regarding eligibility for reduced treaty rates. However, in addition to determining to which taxpayer the source State and/or[2] the resident State allocates income, a proper autonomous treaty-based definition of BO requires courts to examine the existence of 'a contractual or legal obligation to pass on the payment received to another person' that is 'dependent on the receipt of the payment by the direct recipient' (para. 12.4 on Art. 10 of the 2017 OECD MTC). In my view, the existence of such a contractual or legal obligation would prevent the resident state from allocating income to the direct recipient in mist BO-related cases.

Werner Haslehner stated in the 2022 Klaus Vogel Commentary (KVC) on Art. 10 of the 2017 OECD MTC (paras 41 and 43) that 'the determination of which taxpayer is the 'recipient' of dividends is a question for the domestic law of the State applying the tax treaty (i.e., in case of Article 10(2), the source State).' This is also applicable to the determination of BO.

Indeed, the term ‘dividends paid’ or ‘paying the dividends’ under Art. 10(1)-(2) of the LU-CA Tax Treaty has a very broad meaning. It includes any distribution of profits (even notional/deemed)[3] that trigger allocation of income by the source State to a resident of the other State (see KVC on Art. 10, para. 28; Cf. Commentary on Art. 10(1) of the 2017 OECD MTC, para. 7). In that regard, the Commentary on Art. 10 of the OECD MTC indicates that the concept of BO was added to the 1977 OECD MTC ‘to clarify the meaning of the words “paid … to a resident” as they are used in paragraph 1 of the Article’[4] and to ‘address potential difficulties arising from the use’ of those words.[5] The OECD’s Commentary in 2014, fully replicated in 2017, further says that the concept of BO ‘was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country’. Thus, fundamentally, the concept of BO is tied to the words ‘dividends paid … to a resident’ under Art. 10, thereby equating it with the allocation of income rule.

This observation also follows from the Canadian tax jurisprudence. For instance, the TCC in *Preston Family Trust II v. The Queen* held in para. 32 that:

In Canadian tax law, the “beneficial owner” of income is subject to tax on that income. For example, if a creditor instructs a debtor to direct payments of interest to a third party, that does not make those interest payments any less the income of the creditor for purposes of the Act.

Following that interpretative approach, Justice Owen should consider the Luxcos as the BOs under domestic Canadian law insofar as he decided that Husky Energy paid dividends to them in accordance with the ITA, given that there is no beneficial ownership concept in the domestic law that changes this result. In other words, since Husky Energy paid the dividends to the Luxcos, and providing that the ITA allocates the income to the Luxcos as their income sourced in Canada, those companies should be considered by Justice Owen as BOs under Art. 10 LU-CA Tax Treaty. This holds true providing that the view on who is BO is decisive solely from the perspective of the source State, which might be challenged in light of the principle of common intention (good faith) – see the footnote 2. If, however, the Luxcos would not be considered to be the recipient under Luxembourg tax law (because dividend income was not allocated to them), then, contrary to Justice Owen’s finding, and consistent with the opposite obiter dicta in the *Prevost Car* case, the Barbcos should be seen as the BOs in accordance with a very broad meaning of the words ‘dividends paid’ under Art. 10 BA-CA Tax Treaty.

The latter observation seems to follow directly from the wording of Art. 10(2) of the LU-CA Tax Treaty and Art. 10(2) of the BA-CA Tax Treaty insofar as each treaty uses the words ‘if the beneficial owner of the dividends is a resident of the other Contracting State’ and ‘where a resident of the other Contracting State is the beneficial owner of the dividends’, respectively, instead of ‘if the recipient is the beneficial owner of the dividends’. Hence, the wording of those tax treaties does not turn on the identity of the direct recipients of dividends and their BOs to apply reduced WHT in Canada. Such an interpretative outcome is in line with the autonomous treaty interpretation perspective stemming from the change in the wording of Art. 10(2) of the 1995 OECD MTC[6] and the wording of paras 12.2 and 12.7 of the Commentary on Art. 10 of the OECD MTCs from 2003[7] and 2017[8], respectively. The better view is that if the Barbcos are the BOs, even if they are not the direct recipients, they are entitled to the reduced WHT rate in accordance with Art. 10

BA-CA Tax Treaty.

4. The deadly bite of allocation of income/BOs mismatches: a confused BO analysis and a sidestep of the GAAR

Contrary to the observations from the section 3 above and the Part I of this post,[9] Justice Owen's stated that neither the Luxcos nor the Barbcos could benefit from reduced WHT rates under the LU-CA Tax Treaty and the BA-CA Tax Treaty, respectively. He came to this conclusion because he determined that Husky Energy actually paid dividends only to the Luxcos, not to the Barbcos, and the Luxcos were not the BOs. Because they were not the BOs, and because no other Luxembourg tax residents were the BOs, the domestic Canadian WHT rate of 25% should have applied to them (paras 249, 261, 262, and 286) unless they were agents or nominees (in which case they would not be subject to tax by Canada at all but would be responsible for withholding on Canadian-source dividend payments to the principal).[10]

Justice Owen further claimed that the Barbcos could not be subject to WHT in Canada because Husky Energy did not pay dividends to them. Even if they were the BOs, Justice Owen found this fact to be immaterial; it did not change the conclusion that they were not liable to WHT on dividend income from a Canadian source (paras 241, 244, and 249). In making this claim in obiter, as mentioned above, Justice Owen did not equate the concept of BO with the allocation of dividend income by Canada to non-residents. This reasoning appears to emerged from the 'puzzling statutory interpretation twists and turns' of the case (Christians, p. 443). Justice Owen did not follow the OECD Commentary on the concept of BO in cases where direct recipients of dividends (here, the Luxcos) are not their BOs but residents from another tax treaty country are (the Barbcos). If he had done so, he would at least considered the Barbcos as the BOs and agreed with the CRA's reassessment of the dividend rate of 15%, using the BA-CA Tax Treaty. This interpretative outcome of the TCC in the *Husky Energy* case has been characterized by Nikolakakis (pp. 1091, 1093) 'nonsensical'.

Interestingly, as a final point of the analysis of the concept of BO, Justice Owen emphasised in para. 284:

I am not disregarding the separate corporate personality of the Luxcos. I base my conclusions regarding the effect of the securities lending arrangements on my examination of the agreements entered into by the Luxcos with the Barbcos. I am not piercing the corporate veil.

Certainly, Justice Owen did not apply the concept of BO to disregard the Luxcos or pierce their corporate veil for the LU-CA Tax Treaty purposes. Instead, he found that the parties' legal arrangements made all of them ineligible for treaty benefits at all. He did it, however, without properly applying an autonomous treaty-based BO interpretation.

5. Justice Owen's version of the relation between BO & GAAR: a bizarre dynamics and outcome

Before delving into abuse of respective tax treaties, Justice Owen stated that no abuse could arise from the OSLAs because they ultimately led to increase of Canadian WHT from 15% under the

BA-CA Tax Treaty to 25% under the LU-CA Tax Treaty (paras 359-360). That is to say, Justice Owen applied his own judgment to the past transactions – the OSLAs – by denying the status of BOs to the Luxcos to state—in the same very judgment—that such a denial led to full 25% WHT in Canada (no application of the LU-CA Tax Treaty), and therefore no abuse could arise. This is indeed a quite obvious yet troubling observation. It is obvious because his denial of BO status did not leave room for an application of the GAAR. It is troubling because Justice Owen implicitly suggests that the Barbcos must have anticipated the dispute with the CRA and the content of his own judgment in the *Husky Energy* case when devising their planning. That is to say, Justice Owen appears to suggest that the lack of abuse did not follow from the deliberate behaviour of the Barbcos but instead from the effect of his own judgment, totally independent from the actions taken by the taxpayers in that case. I am not sure if the Canadian GAAR, or any GAAR, should be applied in a way that it considers the judgment's outcome in the very GAAR case it is applying as decisive to determining the existence of abuse or its lack thereof. Moreover, Justice Owen's statement that he could find no abuse because his decision increased the WHT from 15% to 25% was truly odd insofar as the TCC could not change the reassessment of the CRA. (Hence, Husky Energy was liable to calculate and withheld 15% WHT instead of 25%, as assessed by the CRA).

Although Justice Owen denied disregarding the separate corporate personality of the Luxcos or piercing their corporate veil, his application of the concept of BO led to similar results. His statement, as cited in section 4 above *in fine*, looks like a cautious rhetorical attempt to avoid identifying his application of BO with that under the Canadian GAAR's concept of abuse, which might lead to disregarding the separate corporate personality or piercing the corporate veil. This rhetorical measure is doomed to fail.

First of all, Justice Owen *de facto* applied the concept of BO under Art. 10(2) LU-CA Tax Treaty in a broad anti-abuse manner to deny the Luxcos benefits under that Treaty, leaving no scope for an application of the Canadian GAAR as he might have done. His interpretation and application of the concept of BO vis-à-vis the Canadian GAAR, or any other anti-abuse measures, contradicted the relation of that concept with such measures, as analysed in Part I of this post and section 3 above.

Although Justice Owen did not admit it, a determination of BO apparently was driven by the fact that diversion of source of profits from Barbcos to Luxcos was in his view solely motivated by tax avoidance. Canadian tax experts (Milet, p. 987 & Nikolakakis, p. 1092)[11] opined that in light of para. 12.4 of the Commentary on Art. 10 of the 2017 OECD MTC, the Luxcos seem to be BOs insofar as they were legally obliged to pay the compensation to Barbcos irrespective of receiving dividends from Husky. Justice Owen did not address that issue. Neither did he apply the concept of BO as an income allocation rule, as he could have and should have. He needed to be driven by an additional factor to deny Luxcos status of BO. In my view, it was precisely the tax avoidance motivation underlying the plan to have the Luxcos receive the dividends instead of the Barbcos that convinced Justice Owen to not consider the Luxcos as the BOs of dividend income (see more on such a pragmatic approach in the determination of the concept of BO by courts, which ignores an autonomous treaty-based meaning of that concept here, Chapters 4-6).

Interestingly, Justice Owen appeared annoyed by the very need to interpret the Canadian GAAR in the *Husky Energy* case at all. For instance, in para. 289, he stated that: (i) the Respondent did not explain why the Minister of National Revenue chose not to assess the Luxcos in addition to, or instead of, the Barbcos; (ii) the Minister's decision to apply the GAAR in addition to the concept of BO 'unnecessarily lengthens and complicates the analysis'; and (ii) 'it is of no relevance to the analysis of the correctness of the Minister's assessments' of Barbcos under the GAAR. ?lea iacta est: once Justice Owen decided that the Luxcos were not the BOs, there was no sense in analysing the GAAR to deny benefits to the Barbcos since their tax avoidance plan failed. As convincingly shown by Ivan Ozai, such bright-line rule case law does not appear to be relevant in tax avoidance cases.

The Minister's tax assessments' of the Barbcos only, and not the Luxcos, meant that Justice Owen focused on the application of Canadian GAAR to identify abusive treaty shopping solely in respect of the Barbcos under the BA-CA Tax Treaty and the LU-CA Tax Treaty. In respect of the former, he stated that Art. X(1) and (2) of the BA-CA Tax Treaty applies 'only if a dividend is paid by a company (a "payer") resident in a contracting state (the "payer state") to a person (a "payee") resident in the other contracting state (the "payee state")' (para 363). In his view Husky Energy did not pay dividends to Barbcos. Hence, he found that Art. X(1) and (2) of the BA-CA Tax Treaty could not apply. He then concluded that the overall tax result (the combined tax benefits)[12] did not stem from the circumvention of the BA-CA Tax Treaty, but from the application of subsection 10(6) of the Income Tax Act Rules (ITARs) and Art. 10(2) of the LU-CA Tax Treaty to the dividends paid by Husky Energy to the Luxcos. Accordingly, despite the 'entirely tax-motivated' transactions (OSLAs) undertaken to avoid Canadian WHT (para. 412), he did not see the abuse of the BA-CA Tax Treaty (para. 367).

Neither, in his view, did the 'entirely tax-motivated' transactions (para. 412) lead to abuse of Canadian tax law or Art. 10(2)a) of the LU-CA Tax Treaty because:

- Subsection 212(2) of the ITA applies to a dividend paid by a company resident in Canada to a non-resident, irrespective of its identity, i.e. it did not matter whether such non-residents were the Barbcos or the Luxcos (para. 414);
- In the hypothetical being considered (the Luxcos were BOs), Art. 10(2)a) of the LU-CA Tax Treaty has applied to the payment of the dividends to the Luxcos 'in the manner contemplated by Canada and Luxembourg', i.e. 'to provide relief from double taxation by allocating the right to tax dividends between Canada and Luxembourg in accordance with the theory of economic allegiance while retaining the protections against the use of conduit-type arrangements afforded by the beneficial owner requirement and the voting power requirement' (paras 414-415).

He then concluded (para. 416) that

Consistent with the theory of economic allegiance described by the majority in Alta Energy, which recognizes that a recipient of passive income need not have any allegiance to the paying country,

the focus of the rationale of Article 10(2) is not how the common shares of Husky came to be owned by the Luxcos, but *whether the Luxcos satisfy the residence requirement, the beneficial owner requirement and the voting power requirement.* **Since the hypothetical being considered assumes these requirements have been satisfied**, I see no basis on which to find that the securities lending arrangements abused Article 10(2). (the emphasis added)

This shows that Justice Owen used a hypothetical that the Luxcos were BOs in a binary (bright-line) way, i.e. he speculated that they were the BOs without any significance of facts and circumstances that occurred in the case. This implies that the hypothetical for Justice Owen made the Luxcos fully fledged rather than borderline BOs. Ultimately, this means that for Justice Owen there was no rationale for a multifold (gradual) approach in determining BO. Indeed, such an approach leaves no room to apply the GAAR to identify and prevent abusive treaty shopping even in borderline fully tax motivated BO related cases. Had Justice Owen properly apply an autonomous treaty-based BO interpretation, his decision would have naturally led to a clearer explanation of the relationship between BO and the GAAR. By not doing so, he conflated the two and failed to apply the GAAR at all.

6. Conclusion

The TCC's judgment in the *Husk Energy* case confirms the observations of Brian J. Arnold (p. 308) that the concept of BO 'is not a good anti-avoidance rule for dealing with conduit and other tax avoidance arrangements' and that '[t]he temptation for desperate tax authorities to use (misuse) any weapon at their disposal to combat tax avoidance should be resisted.' I could add that the temptation for desperate courts to misuse the concept of BO to combat tax avoidance via treaty shopping should also be resisted. 'Other specific and general anti-avoidance rules in both domestic law and tax treaties are better suited for this purpose.'

[1] (Christians, p. 444): 'the interaction between the beneficial ownership analysis and the GAAR analysis that is

perhaps the more puzzling component of this case.'

[2] I.e. whenever there would be a conflict of income allocation between the resident State of a payment's recipient and the source State of such payment, paras 53-54 of 1999 Partnerships Report of the OECD (Partnership Report) indicate that the source State should take into account how an item of income arising in its jurisdiction is treated in the jurisdiction of the taxpayer claiming the benefits under the treaty, i.e. in the resident State of the income recipient. These principles are now reflected in the 2017 OECD MTC and its Commentary and applies to all entities, not only to partnerships, *see* Art. 1(2) of the 2017 OECD MTC and para. 13 of the Commentary on this Article. This Commentary highlights that in case of fiscally transparent partnerships acting as agents or nominees, the source State is not required to follow the income allocation of the resident State to determine BOs, which is an obvious example of the lack of BO. Apart from the mentioned principles of solving conflict s of income allocation, in my view, the most compatible with the principle of interpretation in good faith and the common intention approach to determine the concept of BO would be to do so by considering the allocation of income by both the source State and the resident State rather than only the former or the latter.

[3] I.e. if a State deems that income exists, it most likely also deems that it is paid. *See* Dutch Supreme Court's judgement of 23 May 2014, Case no. 13/02237, para. 3.3.3.

[4] *See* para. 12 of the Commentary on Art. 10(1) of the 2003 OECD MTC.

[5] *See* para. 12.1 of the Commentary on Art. 10(1) of the 2017 OECD MTC.

[6] 'Paragraph 2 was amended on 21 September 1995, by replacing the words "if the recipient is the beneficial owner of the dividends" with "if the beneficial owner of the dividends is a resident of the other Contracting State,", by the report entitled "The 1995 Update to the Model Tax Convention", adopted by the OECD Council on 21 September 1995.'

[7] 'Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.'

[8] 'Subject to other conditions imposed by the Article and the other provisions of the Convention, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).'

[9] I.e. in addition to agents and trustees, the anti-abusive potential of the concept of BO may arise towards conduit entities in extremely obvious situations where such entities have absolutely no power over the income received, usually functioning in isolation from real transactions (sham or simulated transactions). A GAAR or the PPT are adequate rules to address abusive treaty shopping in the remaining, very broad scope in accordance with the policy developments of tax treaties and the object and purpose of tax treaties.

[10] However, the TCC could not change assessment of the Canada Revenue Agency (CRA). Hence, Husky Energy was liable to calculate and withheld 15% WHT instead of 25%, as assessed by the CRA.

[11] Nikolakakis added that: 'While it is possible for the legal ownership of and entitlement to an asset to be separated or bifurcated from the legal ownership of and entitlement to the income produced by an asset, such as in a so-called coupon strip transaction, that was not the intended or somehow inevitable effect of this particular contractual arrangement or of typical contractual arrangements of this type.'

[12] The tax benefit was a reduction of Canadian WHT from 15% under the BA-CA Tax Treaty to 0% as a result of diversions of dividend payment under the OSLAS directly to the Luxcos, instead of to the Barbcos (para. 313). The evidence also clearly indicated, in the view of Justice Owen, that that if Art. 10(2)a) of the LU-CA Tax Treaty had applied to the dividends, 'the Luxcos each would have obtained a tax benefit under the Luxembourg Treaty equal to the reduction of Part XIII tax from 25% to 5%' (para. 320). Those tax benefits, together, 'a more favourable overall tax result' (paras 367 & 412).

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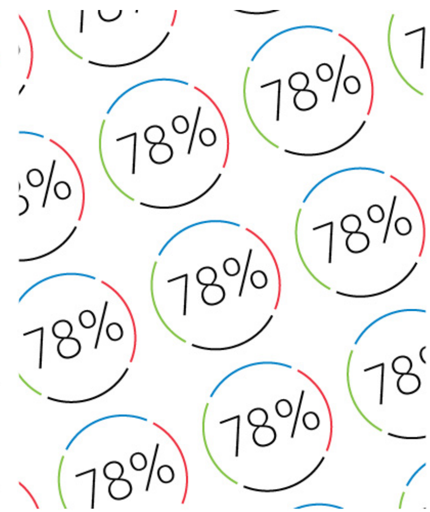

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