ALTA ENERGY AFFIRMS TREATY BENEFITS: A CANADIAN CASE STUDY FOR APPLYING THE M.L.I.

Authors
Kristy J. Balkwill
Benjamin Mann

Tags
Canada
Capital Gains
M.L.I.
O.E.C.D.
P.P.T.
Tax Treaties

Kristy J. Balkwill is a partner in Miller Thomson LLP's Tax Group. Her practice focuses primarily on international tax structuring, providing Canadian income tax advice regarding cross-border M&A transactions and global corporate reorganizations. Kristy has advised on international asset and share acquisitions and sales, multi-jurisdictional mergers and spin-offs, international trust structurings, and various types and levels of audits by the Canada Revenue Agency. Kristy is admitted to practice law in Ontario (Canada) and N.Y.

Benjamin Mann is a tax associate in Miller Thomson LLP's Toronto office. He has experience in developing corporate and trust structures in both domestic and international contexts. He has also assisted in preparing administrative and judicial appeals on behalf of taxpayers.

INTRODUCTION

The Tax Court of Canada in *Alta Energy Luxembourg S.A.R.L. v. The Queen*[1] ("*Alta Energy*") and its interplay with Canada's potential future application of the principal purpose test ("P.P.T.") under the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the "Multilateral Instrument" or "M.L.I.") designed by the O.E.C.D., which Canada signed on June 7, 2017.

Alta Energy resulted from an assessment of Alta Energy Luxembourg S.A.R.L. ("Luxco"), a company resident in Luxembourg for the purposes of the double income tax convention concluded between Canada and Luxembourg (the "Canada-Luxembourg Treaty"),[2] following its sale of shares of Alta Energy Partners Canada Ltd. ("Canco") to Chevron Canada Ltd. ("Chevron"), an arm's length party.

It should be noted that a Notice of Appeal was filed with respect to *Alta Energy* with the Federal Court of Appeal on October 1, 2018.

BACKGROUND

In the spring of 2011, Blackstone Group LP and Alta Resources LLC (together, the "Investors") formed Alta Energy Partners, LLC ("USco"), a limited liability company formed pursuant to the laws of Delaware. In June 2011, the Investors incorporated Canco, a wholly owned subsidiary of USco. Canco was granted the right to explore, drill, and extract hydrocarbons from an area in Alberta designated under licenses (the "Licenses") granted by the government of Alberta.

Pursuant to the double income tax convention between Canada and the U.S. (the "Canada-U.S. Treaty"),[3] a sale of Canco by USco would likely have resulted in a capital gain subject to tax in Canada as well as the U.S.; the Investors had been advised that the total investment in Canco was expected to grow between $300 and $400 million in two years.

---

1 2018 TCC 152.

2 *Convention Between the Government of Canada and the Government of the Grand Duchy of Luxembourg For the Avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income and on Capital,* signed on September 10, 1999, as amended by the Protocol signed on May 8, 2012.

3 *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital*, as amended by the Protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007.

The Investors determined that the decision to have Canco held by USco was a mistake[4] and realized that a restructuring was necessary in order to address current[5] and future adverse income tax consequences.

In December 2011, the Investors corresponded with Luxembourg tax authorities regarding the tax regime that would be applicable should a corporation resident in Luxembourg (*e.g.*, Luxco) dispose of the shares of Canco.[6]

"Canadian income tax is payable on the gain realized from the disposition of Taxable Canadian Property . . . that is not Treaty Protected Property."

In April 2012, the Investors formed Luxco. Luxco was formed in order to hold the Investors' participations in Luxembourg and in foreign companies.[7] Luxco's sole shareholder, *Alta Energy* Canada Partnership, was a partnership established pursuant to the laws of Alberta.

On the same day, USco transferred the shares of Canco to Luxco (the "Transfer"). The Transfer would have resulted in a capital gain in Canada to USco, except that the Canada Revenue Agency (the "C.R.A.") accepted that Canco's shares on the date of the Transfer had a fair market value ("F.M.V.") equal to USco's adjusted cost base in Canco, resulting in zero gain. However, the court noted[8] that the Investors undoubtedly incurred significant legal costs in connection with the establishment of the revised structure.

Canco continued to acquire additional Licenses. In September 2013, Luxco agreed to sell its shares of Canco to Chevron (the "Sale").

Relying on Articles 13(4) and 13(5) of the Canada-Luxembourg Treaty, Luxco did not pay any income tax in Canada with respect to the Sale.

TAX CONSEQUENCES UNDER THE INCOME TAX ACT AND THE CANADA-LUXEMBOURG TREATY

Pursuant to the Income Tax Act (Canada) (the "I.T.A."),[9] Canadian income tax is payable on the gain realized from the disposition of Taxable Canadian Property, as defined in the I.T.A.,[10] that is not Treaty Protected Property, as defined in the I.T.A.[11]

Luxco conceded that the shares of Canco were Taxable Canadian Property at the time of the Sale because the shares of Canco derived more than 50% of their value

---

4 *Supra* note 1, para. 19.

5 *E.g.*, anti-deferral rules in Subpart F of the Code.

6 *Supra* note 1, para. 21.

7 *Id.*, para. 22.

8 *Id.*, para. 25.

9 R.S.C., 1985, c.1 (5th Supp.).

10 Subsection 248(1) of the I.T.A. Generally, a share of the capital stock of a corporation (*e.g.*, Canco) is Taxable Canadian Property if, at the time of its disposition or within 60 months prior to that time, more than 50% of the F.M.V. of the share was derived, *inter alia*, directly or indirectly from one or any combination of the following: (i) real or immovable property situated in Canada, (ii) Canadian Resource Properties, (iii) Timber Resource Property (as defined in subsection 13(21) of the I.T.A.), and (iv) options or interests with respect to any of the foregoing.

11 Subsection 248(1) of the I.T.A.

from Canadian Resource Property, as defined in the I.T.A.[12] However, Luxco contended that the shares of Canco were Treaty Protected Property and therefore exempt from tax under the I.T.A.

Treaty Protected Property is defined[13] as follows:

> . . . property any income or gain from the disposition of which by the taxpayer at that time would, because of a tax treaty with another country, be exempt from tax under Part I [of the I.T.A.].

Article 13 of the Canada-Luxembourg Treaty governs, *inter alia*, capital gains realized by a resident of one contracting state (Luxembourg) arising from the disposition of property in the other state (Canada).

Article 13(4) and (5) of the Canada-Luxembourg Treaty states:

> 4. Gains derived by a resident of a Contracting State from the alienation of:
>
> (a) shares (other than shares listed on an approved stock exchange in the other Contracting State) forming part of a substantial interest in the capital stock of a company the value of which shares is derived principally from immovable property situated in that other State; or
>
> (b) an interest in a partnership, trust or estate, the value of which is derived principally from immovable property situated in that other State,
>
> may be taxed in that other State. For the purposes of this paragraph, the term "immovable property" *does not include property (other than rental property) in which the business of the company, partnership, trust or estate was carried on*; and a substantial interest exists when the resident and persons related thereto own 10 per cent or more of the shares of any class or the capital stock of a company.
>
> 5. Gains from the alienation of any property, other than that referred to in paragraphs 1 to 4[14] shall be taxable only in the Contracting State of which the alienator is a resident. [emphasis added]

The parties agreed that the shares of Canco derived their value principally from immovable property situated in Canada (per Article 13(4)(a) of the Canada-Luxembourg Treaty); at issue was whether the shares of Canco fell into the exemption for immovable property in which the business of the company (*e.g.*, Canco) was carried on (the "Immovable Property Exemption"). If the shares of Canco fall into the Immovable Property Exemption, the Sale should not be subject to tax in Canada pursuant to Article 13(4)(a) of the Canada-Luxembourg Treaty and should only be

---

[12] Subsection 66(15).

[13] Subsection 248(1) of the I.T.A.

[14] The parties did not raise arguments regarding Articles 13(1)-13(3) of the Canada-Luxembourg Treaty.

subject to tax in Luxembourg pursuant to Article 13(5) of the Canada-Luxembourg Treaty. In contrast, if Canco were found not to carry on its business through Canadian Resource Properties, the Sale should be subject to tax in Canada pursuant to Article 13(4)(a) of the Canada-Luxembourg Treaty and subsection 2(3) of the I.T.A.

As an alternative, the Minister of National Revenue (the "Minister") raised an argument under Canada's general anti-avoidance rule ("Canada's G.A.A.R.")[15] contending that a misuse or abuse of the I.T.A. and/or the Canada-Luxembourg Treaty resulted from the fact that Luxco, although a resident of Luxembourg for the purposes of the Canada-Luxembourg Treaty,[16] was created and became the owner of the shares of Canco for no purpose other than avoiding Canadian income tax on any gain that Luxco might realize from the Sale.[17]

DISCUSSION AND ANALYSIS

Does the Sale Fit into the Immovable Property Exemption?

As noted above, when a nonresident of Canada disposes of Taxable Canadian Property, Canada asserts the right to tax the nonresident on the gain, unless the property is Treaty Protected Property. The parties in *Alta Energy* agreed that Luxco's shares in Canco constituted Taxable Canadian Property on the basis that they derived more than 50% of their F.M.V. from Canadian Resource Properties;[18] the disagreement was whether the shares constituted Treaty Protected Property.

The court's reasoning began with its determination that Articles 13(1) and 13(5) of the Canada-Luxembourg Treaty assisted in illustrating the purpose of Article 13(4).[19] Article 13(1) of the Canada-Luxembourg Treaty provides that gains derived from the disposition by a party in one jurisdiction (*e.g.*, Luxembourg) of immovable property in another jurisdiction (*e.g.*, Canada) will be subject to tax in the state in which the property was located (*e.g.*, Canada). Article 13(4) of the Canada-Luxembourg Treaty supplements this rule by preventing a taxpayer from simply conducting a share sale, rather than an asset sale, in order to avoid tax in the jurisdiction in which the immovable property is situated.[20]

The court appears to have determined that this rule indicates a general principle that, in concluding the Canada-Luxembourg Treaty, Canada and Luxembourg generally gave up their rights to tax capital gains as an incentive to promote capital inflows, except when the gain was principally derived from immovable property other than immovable property in which a business is carried on.[21] According to the court, Article 13(5) of the Canada-Luxembourg Treaty embodied that principle.[22]

---

15 Section 245 of the I.T.A.

16 Article 4.

17 *Supra* note 1, para. 75.

18 *Supra* note 10.

19 *Supra* note 1, paras. 39 and 40.

20 *Id.*, para. 41.

21 *Id.*, paras. 39-41.

22 *Ibid.*

The court also relied heavily on a 1991 position paper (the “Position Paper”)[23] authored by an official of the Government of Canada.[24] According to the Position Paper,[25] the C.R.A. received numerous requests for technical interpretations concerning what is meant by “property, other than rental property, in which the business of the company was carried on” (“Excluded Property”) in the application of certain double income tax conventions signed by Canada and in the context of resource industries.[26] The Position Paper was written in response to those requests and provides as follows:

> **Positions** . . .
>
> 3. Oil and gas reserves, *mines and royalty interests are Excluded Property if the owner is actively engaged in the exploitation of natural resources and if such assets are actively exploited or kept for future exploitation by such owner,* subject to exceptions resulting to hydrocarbons in the Canada-United Kingdom Convention. [emphasis added][27]

The Position Paper also provides the rationale for its positions.

The court interpreted the comments in Position 3 as setting out two conditions for oil and gas reserves to qualify as Excluded Property: (i) The corporation must be actively engaged in the exploration of the reserve, and (ii) the reserve must be actively exploited or kept for future exploitation by the owner.[28]

The court then discussed the nature of the oil and gas exploitation industry (the “Industry”). Generally, the court described how the Industry requires significant upfront capital investment and a trial and error methodology for finding and exploiting reserves, acknowledging that not every part of a working interest can be exploited at once.[29]

In order to maximize the opportunities for exploiting a reserve, the court determined that Canco, directly and indirectly, purchased multiple Licenses and took steps to “properly delineate the part of the formation that it controlled in order to plan how and when it would drill wells, extract hydrocarbons, and bring the hydrocarbons to the market.”[30] Canco was not drilling on all areas for which it had Licenses but chose locations to drill based on their likelihood to benefit the entire operation. The court focused on the fact that Canco was at all times using the best practices of the Industry to develop its reserves.[31]

---

23 The authors obtained a copy of the Position Paper from the court. The author of the Position Paper is G. Arsenault; the Position Paper is dated February 28, 1991.

24 *Supra* note 1, para. 42.

25 In the *Background* section on page 1.

26 See also *supra* note 1, para. 44.

27 We note that the Position Paper was published in 1991; it is unknown whether the positions in the Position Paper reflect the current positions of the C.R.A.

28 *Supra* note 1, para. 45.

29 *Id.*, paras. 46-68.

30 *Id.*, para. 65.

31 *Id.*, para. 64.

In arguing that the shares of Canco did not constitute Excluded Property, the Minister took the position that only the properties where the Licenses were being actively used – *i.e.*, where drilling was actually taking place – could constitute Excluded Property. In other words, the Licenses to exploit hydrocarbons located under land being drilled could constitute Excluded Property on the basis that those properties were each a property in which the business of Canco was being carried on; however, Licenses to exploit hydrocarbons located under land that Canco was not drilling would not be Excluded Property, as Canco would not be conducting business on parcels where no drilling was actively taking place.

The court disagreed with this reasoning. The court determined that the Canada-Luxembourg Treaty negotiators "intended for a resource property to qualify as Excluded Property when such property is developed in accordance with the industry's best practices."[32]

In its interpretation of the Canada-Luxembourg Treaty, the court determined that the purpose of the Immovable Property Exemption is to attract foreign direct investments and that it is, therefore, also reasonable to assume that the negotiators of the Canada-Luxembourg Treaty intended for the Immovable Property Exemption to be granted in accordance with Industry practices.[33] This would mean that, although Canco was not drilling on all of the properties for which it had Licenses, so long as Canco obtained the property for use in its exploitation operations in a manner that was in keeping with Industry practices, Canco could be said to be carrying on its business in such properties for the purposes of Article 13(4) of the Canada-Luxembourg Treaty.

"The negotiators of the Canada-Luxembourg Treaty intended for the Immovable Property Exemption to be granted in accordance with Industry practices."

The court further determined[34] that the Minister's interpretation would have been contrary to the terms expressed in the Position Paper, which included in the definition of Excluded Property, assets that are "actively exploited or *being kept for future exploitation*" [emphasis added], provided that the corporation was otherwise carrying on an active business.[35]

Although the Position Paper is not binding law, the court stated that, because it was a stated position from the C.R.A., taxpayers should be able to rely on it.[36]

Since Canco was conducting its business on all of the properties for which it had Licenses, the court determined that such properties constituted Excluded Property, such that the Sale fit within the Immovable Property Exemption and should not be subject to tax in Canada.[37]

Does Canada's G.A.A.R. Apply to the Transactions?

While a full analysis of Canada's G.A.A.R. is outside the scope of this article, generally, section 245 of the I.T.A. can apply to prevent a taxpayer from realizing a tax benefit once a transaction or series of transactions meet three criteria:

---

32 *Id.*, para. 64. The court also added, in note 10, "In this regard, I share the opinion expressed in the Position Paper."

33 *Id.*, para. 68.

34 *Id.*, para. 55.

35 *Ibid.*

36 *Id.*, para. 56.

37 *Id.*, para. 69.

- The transaction or series of transactions resulted in a "tax benefit."[38]
- The transaction or series of transactions constituted an "avoidance transaction."[39]
- It cannot reasonably be considered that the transaction or series of transactions would not result directly or indirectly in (i) a misuse of the provisions of the I.T.A., a tax treaty, or similar legislation, or (ii) an abuse having regard to the provisions of the I.T.A., tax treaty, or similar legislation read as a whole.[40]

Luxco agreed that, as a result of the restructuring, there had been a tax benefit and an avoidance transaction but argued that the avoidance transaction was not abusive.[41] The only issue before the court was whether or not there had been a misuse or abuse of a provision of the I.T.A. or the Canada-Luxembourg Treaty.

Pursuant to jurisprudential procedure concerning Canada's G.A.A.R.,[42] the court first looked to the "object, spirit, and purpose" of the I.T.A. and the Canada-Luxembourg Treaty, noting that statutory interpretation under Canada's G.A.A.R. differs from traditional word-based interpretation.[43] The court restated the general application of Canada's G.A.A.R. analysis:[44]

> Whereas, under the modern rule of statutory interpretation the analysis seeks to determine what the meaning of a provision is, under the GAAR, statutory interpretation is used to determine the object, spirit or purpose of the provision.[45] The object, spirit or purpose is the rationale underlying the provision. Transactions may be found abusive of a provision's underlying rationale, even though they comply with the literal, contextual and purposive meaning of the words of the statute.[46]

The court briefly dealt with arguments as to whether the Sale could be a misuse or abuse of provisions of the I.T.A. and determined that it could not:

> It is clear that those provisions[[47]] are not intended to operate in the case where a non-resident realizes a gain from the disposition of the 'treaty protected property' . . . I have concluded that the [shares of Canco] are 'treaty protected property.'[48]

---

38 As defined in subsection 245(1) of the I.T.A.

39 As defined in subsection 245(3) of the I.T.A.

40 Subsection 245(4) of the I.T.A.

41 *Supra* note 1, para. 70.

42 See, *e.g.*, *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54.

43 *Supra* note 1, para. 71.

44 *Ibid.*

45 *Copthorne Holdings Ltd. v. R.*, 2011 SCC 63 [2011] 3 S.C.R. 721 (S.C.C.), para. 70.

46 *Id.*, para. 109.

47 Sections 38 and 39, subsection 2(3), and para. 115(1)(b) of the I.T.A.

48 *Supra* note 1, para. 74.

Having determined that the shares of Canco were Treaty Protected Property, which should be exempt from tax under the I.T.A., the court stated that all of the provisions of the I.T.A. operated in the manner intended by Canadian Parliament – *i.e.*, exempting Treaty Protected Property from Canadian tax. Therefore, the Sale should not have resulted in any misuse or abuse of the I.T.A.

The remaining question was whether there had been a misuse or abuse of the Canada-Luxembourg Treaty.

The Minister argued that the misuse or abuse resulted from the fact that Luxco, although a resident of Luxembourg for the purposes of Article 4 of the Canada-Luxembourg Treaty, was created and became the owner of the shares of Canco for no purpose other than avoiding Canadian income tax on the gain realized on the Sale. The Minister also noted that Luxco paid no tax in Luxembourg with respect to the Sale.[49]

The court stated[50] that the avoidance of "foreign tax" is irrelevant and further stated that the term "tax benefit" does not include a tax benefit under foreign law.[51]

The court went on to state that, under an analysis of Canada's G.A.A.R., the court was required to identify the rationale underlying the particular provisions of the Canada-Luxembourg Treaty, and not "a vague policy supporting a general approach to the interpretation of the [Canada-Luxembourg Treaty] as a whole."[52]

Similar to the court's analysis with respect to Canada's G.A.A.R. concerning the I.T.A., the court generally found that the provisions of the Canada-Luxembourg Treaty were applied by Luxco in the manner in which they were intended.

The court made several references to the particularities of some of Canada's other tax treaties. The court noted that the Canada-Luxembourg Treaty does not contain a limitation on benefits provision[53] ("L.O.B. Provision") that might deny access to treaty benefits[54] and further noted that the Canada-Luxembourg Treaty includes a

---

49 *Supra* note 1, para. 75.

50 *Id.*, note 14.

51 The court also stated at para. 85:

> When the [Canada-Luxembourg Treaty] was negotiated, the Canadian treaty negotiators were aware of the fact that Luxembourg allowed its resident to avoid Luxembourg income tax on gains arising from the sale of shares of foreign corporations in broad circumstances. In this light, if Canada wished to curtail the benefits of the [Canada-Luxembourg Treaty] to potential situations of double taxation, Canada could have insisted that the exemption provided for under Article 13(5) [of the Canada-Luxembourg Treaty] be made available only in the circumstance where the capital gain was otherwise taxable in Luxembourg. Canada and Luxembourg did not choose this option. It is certainly not the role of the court to disturb their bargain in this regard

52 *Supra* note 1, para. 77.

53 As can be found in Article XXIX A of the Canada-U.S. Treaty.

54 *Supra* note 1, para. 80.

specific carve-out for immovable property in which the business of a company is carried on (*i.e.*, the Immovable Property Exemption).

The court stated that it is important to consider the O.E.C.D.'s Model Tax Convention on Income and Capital[55] and its commentaries (the "O.E.C.D. Model Treaty") because the O.E.C.D. Model Treaty often serves as a baseline in Canadian treaty negotiations.[56] The court noted that the Immovable Property Exemption is not included in the O.E.C.D. Model Treaty and, as a result, the inclusion of the Immovable Property Exemption in the Canada-Luxembourg Treaty is significant because it demonstrates a specific intention of one or both of the parties to the Canada-Luxembourg Treaty to diverge from the usual approach.[57]

> The OECD Model Treaty does not include a carve-out for immovable property in which the business of the company is carried on. Departure from the model tax treaty may be significant as it demonstrates the intent of one, or both, parties to diverge from the general approach. When there is no common agreement on a specific point at the start of the negotiations, a divergence may be the result of a bargain struck by the parties. In the instant case, it is apparent that the parties intended to depart from the [O.E.C.D. Model Treaty]. This departure involved carving out from the definition of immovable property properties where economic activities were carried on.
>
> Parties to a tax treaty are presumed to know the other country's tax system when they negotiate a tax treaty; they are presumed to know the tax consequences of a tax treaty when they negotiate amendments to that treaty. The OECD commentaries highlight that some states—like Luxembourg—generally do not tax capital gains: OECD commentary on Article 13, 28.12. It is then the responsibility of the state that does tax capital gains to prevent a double exemption if it wishes to do so.[58]

The court went on to say that if Canada wanted to prevent Luxembourg residents from escaping taxation on transactions that are not taxed in Luxembourg, it could have considered this when negotiating the Canada-Luxembourg Treaty, but did not. It was therefore "certainly not the role of the court to disturb their bargain in this regard."[59]

The Minister also raised the argument that benefits for Luxco under the Canada-Luxembourg Treaty should be denied because Luxco's actions constituted "treaty shopping," which should constitute an abuse of the Canada-Luxembourg Treaty.[60] The term "treaty shopping" is not defined in the I.T.A. nor in any double income tax convention signed by Canada. The O.E.C.D. Glossary of Tax Terms defines "treaty shopping" as:

---

55 Dated December 18, 2017.

56 *Supra* note 1, para. 82.

57 *Id.*, para. 83.

58 *Id.*, paras. 83 and 84.

59 *Id.*, para. 85. See also *supra* note 50.

60 *Id.*, para. 92.

> **TREATY SHOPPING** – An analysis of tax treaty provisions to structure an international transaction or operation so as to take advantage of a particular tax treaty. The term is normally applied to a situation where a person not resident of either the treaty countries establishes an entity in one of the treaty countries in order to obtain treaty benefits.

Again, the court referred to other tax treaties to which Canada is a party and compared this issue to the L.O.B. Provision in the Canada-U.S. Treaty.[61] The court noted that the U.S. had developed comprehensive anti-treaty shopping rules that demonstrate how parties could impose conditions other than residence in order to curtail treaty shopping.[62]

Instead, the court stated[63] that the O.E.C.D. Model Treaty,[64] published at the time of the signing of the Canada-Luxembourg Treaty, as well as the Canada-Luxembourg Treaty, only contain "a very narrow" anti-abuse or treaty shopping rule in Articles 10, 11, and 12, based on beneficial ownership and impacting only dividends, interest, and royalties (respectively).[65]

The court did note, however, that Canada's Department of Finance has been in the process of reconsidering the country's bilateral approach to treaty shopping and, in 2013, released a consultation paper[66] (the "Consultation Paper") requesting comments from taxpayers. In summary, the Consultation Paper proposed two approaches: (i) the continuation of the bilateral (treaty) approach or (ii) a new approach that would lead to the enactment of a domestic anti-treaty shopping rule that, potentially, would override all of Canada's tax treaties (the "Domestic Approach"). The court commented that Finance favored the Domestic Approach since such domestic legislation could be enacted more swiftly than international treaties.[67] Finance indeed had previously confirmed this by announcing in the 2014 Federal Budget[68] that it would proceed unilaterally under the Domestic Approach and provided proposed anti-treaty-shopping rules (the "Proposed Rules"). The Proposed Rules have not been enacted through Canadian legislation.

The court stated that the Minister sought to achieve the same result using Canada's G.A.A.R. as should be achieved under the Proposed Rules, *i.e.*, to use Canada's

---

[61] The court referenced Article XXIX-B of the Canada-U.S. Treaty (being the article relating to Taxes Imposed by Reason of Death); however, we respectfully believe that the court meant to reference Article XXIX-A of the Canada U.S. Treaty.

[62] *Supra* note 1, para. 94.

[63] *Id.*, para. 93.

[64] O.E.C.D. Model Tax Convention on Income and on Capital, June 1998.

[65] In *Alta Energy* (*supra* note 1), the court states (in para. 93) that the certain types of income include dividends, rents, and royalties and not dividends, interest, and royalties; however, the court does make note of Article 11 of the Canada-Luxembourg Treaty, which governs interest.

[66] Consultation Paper on Treaty Shopping – The Problem and Possible Solutions, August 12, 2013.

[67] *Supra* note 1, para. 95.

[68] Budget 2014, Annex 2 – Tax Measures: Supplementary Information, Consultation on Tax Planning by Multinational Enterprises.

G.A.A.R. in order to "deal with what Finance now believes is an unintended gap in the [Canada-Luxembourg Treaty]."[69] Relying on prior case law,[70] the court ruled that the Minister could not rely on Canada's G.A.A.R. to deal with an unintended gap in the Canada-Luxembourg Treaty[71] and generally supported the Federal Court of Appeal's view[72] that a taxpayer cannot misuse or abuse a treaty by claiming an exemption provided by the treaty.[73]

It should be noted that the court also quickly rejected an argument by the Minister that Luxco should be denied benefits under the Canada-Luxembourg Treaty because it was a "conduit."[74] The court determined that Luxco was the beneficial owner of the shares of Canco and stated that the Minister's argument that Luxco was acting as a conduit appeared to be inconsistent with the Minister's acceptance of Luxco as the "beneficial owner" of the shares of Canco, based on the fact that Luxco was the lawful recipient of the proceeds from the Sale.

Having determined that the Sale fit within the Immovable Property Exemption and that there was no misuse or abuse under Canada's G.A.A.R. or the Canada-Luxembourg Treaty, the court ruled in favor of Luxco.

As previously noted, the Minister filed a Notice of Appeal with respect to *Alta Energy* with the Federal Court of Appeal on October 1, 2018.

How Would the Multilateral Instrument and the P.P.T. Impact the Transactions?

Canada and Luxembourg have each signed the M.L.I., although, as of the time of writing, neither has deposited its instrument of ratification, acceptance, or approval with the O.E.C.D.[75] The Parliament of Canada had its first reading of Bill C-82 – An Act to Implement a Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Bill") – on June 20, 2018, in the House of Commons of Canada. The Bill had its second readings in the House of Commons on September 28, 2018, and October 15, 2018, and, as of the time of writing, has been referred to the Standing Committee on Finance.

Article 7(1) of the M.L.I. provides a rule, often referred to as the P.P.T., designed to prevent perceived tax treaty abuses. Article 7(1) of the M.L.I. states:

> 1. 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

---

69 *Supra* note 1, para. 98.

70 *Garron Family Trust (Trustee of) v. R.*, 2009 TCC 450, and *Garron Family Trust (Trustee of) v. R.*, 2010 FCA 309.

71 *Supra* note 1, para. 98.

72 In *Garron Family Trust (Trustee of) v. R.*, 2010 FCA 309.

73 *Supra* note 1, paras. 99-100.

74 *Id.*, paras. 86-89.

75 A requirement for the M.L.I. to come into effect with respect to the Canada-Luxembourg Treaty. For additional information on parties to the M.L.I. and implementation status, see Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

> 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.

"If the benefit is in accordance with the 'object and purpose' of the relevant provisions of a treaty, Article 7 should not apply to undo the tax benefit."

The court did not address the application of the M.L.I. or the P.P.T. in *Alta Energy*; however, since the transactions at issue occurred in 2013, it is unlikely that the M.L.I. would have been applicable.

There are similarities between Article 7(1) of the M.L.I. and Canada's G.A.A.R. For example, pursuant to the P.P.T., one must consider whether there has been an arrangement or transaction that resulted directly or indirectly in a benefit. Recall that, pursuant to Canada's G.A.A.R., there must be a transaction or series of transactions that resulted in a tax benefit.

In *Alta Energy*, Luxco essentially admitted that the transfer of the shares of Canco by USco to Luxco was not arranged primarily for a *bona fide* purpose other than to obtain a tax benefit.[76] As a result, Luxco may have also failed the first part of the P.P.T.

However, the P.P.T. also includes a saving provision: If the benefit is in accordance with the "object and purpose" of the relevant provisions of a treaty, Article 7 should not apply to undo the tax benefit, notwithstanding the impugned transaction's principal purpose.

This language is similar to the third prong of Canada's G.A.A.R., which asks courts to determine the object, spirit, and purpose of the relevant provisions of the applicable legislation or treaty and only apply Canada's G.A.A.R. when there has been a misuse or abuse of such provisions.

In determining that the rationale behind the Immovable Property Exemption in Article 13(4) of the Canada-Luxembourg Treaty was "to exempt residents of Luxembourg from Canadian taxation where there is an investment in immovable property used in a business,"[77] the court resolved that there was no misuse or abuse of the relevant provisions of the Canada-Luxembourg Treaty. Therefore, Canada's G.A.A.R. did not apply to undo the tax benefit provided by the Canada-Luxembourg Treaty.

Had the court been required to consider Article 7(1) of the M.L.I. in *Alta Energy*, it seems likely that the result would have been the same. If the benefit that the transactions provided was only to exempt Luxco, a resident of Luxembourg, from tax on an (indirect) disposition of immovable property used in an active business, then this should be in accordance with their object and purpose, under the court's understanding of the relevant provisions of the Canada-Luxembourg Treaty.

The so-called misuse or abuse language in Canada's G.A.A.R.[78] implies a more serious threshold than one might expect to be imposed under the M.L.I. Practically

---

[76] *Supra* note 1, para. 70.

[77] *Id.*, para. 100.

[78] Subsection 245(4) of the I.T.A.

though, Canadian courts have generally conducted the misuse or abuse analysis by determining whether the avoidance transaction at issue frustrated the object, spirit, or purpose of the provisions at play, and applying Canada's G.A.A.R. in situations where transactions have done so. This analysis may be similar to what courts will be asked to do when considering the P.P.T. under the M.L.I.

CONCLUSION

The court's decision in *Alta Energy* was based on the court's understanding of Articles 13(4) and 13(5) of the Canada-Luxembourg Treaty. While the court did not expressly consider the M.L.I., its reasoning is informative with respect to how a future court might work its way through a P.P.T. analysis. As the analyses under Canada's G.A.A.R. and the M.L.I.'s P.P.T. appear to be quite similar, it may be helpful to look to prior Canadian decisions on Canada's G.A.A.R. for discussions regarding how future courts, Canadian and otherwise, may interpret and apply the P.P.T. under the M.L.I.

Disclaimer: *This article has been prepared for informational purposes only and is not intended to constitute advertising or solicitation and should not be relied upon, used, or taken as legal advice. Reading these materials does not create an attorney-client relationship.*