File number: 39113

IN THE SUPREME COURT OF CANADA
(ON APPEAL FROM THE FEDERAL COURT OF APPEAL)

BETWEEN:

HER MAJESTY THE QUEEN

Appellant
(Appellant)

and

ALTA ENERGY LUXEMBOURG SARL

Respondent
(Respondent)

AMENDED FACTUM OF THE APPELLANT

(Pursuant to Rule 42 of the *Rules of the Supreme Court of Canada,* SOR/2002-156)

Counsel for the Appellant

ATTORNEY GENERAL OF CANADA
Department of Justice Canada
British Columbia Region
900 – 840 Howe Street
Vancouver, British Columbia
V6Z 2S9
Fax: (604) 666-2214

Per: Michael Taylor
Natalie Goulard
Tel.: (604) 775-6014 / (514) 496-6456
Email: michael.taylor@justice.gc.ca
natalie.goulard@justice.gc.ca

Agent for the Appellant

DEPUTY ATTORNEY GENERAL OF CANADA
Department of Justice Canada
Civil Litigation Branch
50 O'Connor Street
Ottawa, Ontario
K1A 0H8
Fax: (613) 954-1920

Per: Christopher M. Rupar
Tel.: (613) 670-6290
Email: christopher.rupar@justice.gc.ca

Counsel for the Respondent

THORSTEINSSONS LLP
Bay Wellington Tower
181 Bay Street, Suite 3300
Toronto, Ontario
M5J 2T3

Per: Matthew G. Williams
E. Rebecca Potter
Tel.: (416) 864-9104
(416) 864-0855
Email: mgwilliams@thor.ca
erpotter@thor.ca

Agent for the Respondent

SUPREME ADVOCACY LLP
340 Gilmour Street
Ottawa, Ontario
K2P 0R3

Per: Marie-France Major
Tel.: (613) 695-8855
Fax: (613) 695-8580
Email: mfmajor@supremeadvocacy.ca

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PART I – OVERVIEW AND FACTS

A. <u>Overview</u>

1. The respondent was incorporated in Luxembourg by shareholders in the United States and the Cayman Islands as part of an exit strategy for liquidating an investment in Canadian oil and gas properties. Those shareholders were not entitled to a reduction of Canadian tax under any tax treaty. So they interposed a Luxembourg corporation in order to benefit from an exemption under Canada's tax treaty with Luxembourg. A $380 million gain was routed to Luxembourg for tax purposes while the sale proceeds went directly to the ultimate shareholders. Other than obtaining the tax benefit, the respondent had no economic connection with Luxembourg at all – no office, no employees, no phone line or email address in Luxembourg, no capital other than loans from the US and Cayman shareholders, and no business activity in Luxembourg. The sole purpose for the incorporation was to avoid Canadian tax for the benefit of the respondent's ultimate shareholders.

2. The General Anti-Avoidance Rule (GAAR) in section 245 of the *Income Tax Act* is Canada's primary legislative response to avoidance transactions that abuse its tax legislation, including tax treaties. The GAAR denies tax benefits that result from abusive transactions. Failure to apply the GAAR to avoidance transactions like those in this case erodes Canada's tax base and leaves Canada's tax treaty network largely defenseless against exploitation and abuse.

3. "Treaty shopping" generally refers to a situation in which a person who is not entitled to the benefits of a tax treaty uses an intermediary entity that is entitled to such benefits in order to indirectly obtain them. In *Crown Forest,* this Court held that treaty shopping should be discouraged because it is contrary to the basis on which Canada cedes its taxing rights under its bilateral tax treaties.

4. The provisions of the Canada-Luxembourg treaty that were engaged in this case are intended to encourage trade and investment by avoiding double taxation of each other's residents. They are not intended to facilitate a tax-free divestment by a resident of a third state. Their purpose is to allocate taxing rights between the contracting states with respect to different categories of income based on the strength of the economic connection of those residents and of those categories of income with each contracting state. Tax treaties are decidedly not

intended to benefit residents of third party states who have no meaningful economic connection to one of the treaty partners.

5. The Federal Court of Appeal failed to conduct either step of the GAAR abuse analysis properly. Instead of identifying the rationale animating the distributive rules of the agreement between Canada and Luxembourg to allocate taxing rights, the Federal Court of Appeal gave weight only to the text of the treaty. The Federal Court of Appeal also failed to examine the overall result of the transactions in this case.

6. In so doing, the Federal Court of Appeal rendered the GAAR largely inapplicable to abuses of Canada's tax treaties. Its decision provides a roadmap to a resident of any state who seeks to avoid Canadian tax on similar capital gains regardless of whether Canada has extended treaty benefits to residents of that particular state. This result erodes the integrity of Canada's network of bilateral tax treaties.

B. Facts

1. Canadian oil and gas properties were acquired through Alta Energy Partners Canada Ltd.

7. In April 2011, Alta Resources LLC (Alta Resources), a Texas-based oil and gas firm, and Blackstone Group LP, a New York-based private equity firm, founded Alta Energy Partners, LLC (Alta US), a Delaware company. The purpose of Alta US was to acquire and develop unconventional oil and natural gas properties in North America.[1]

8. The shareholders of Alta US included Alta Resources Investments, LLC (Alta Investments) (a Texas LLC held by Alta Resources and certain "friends and family" of Alta Resources), and two Blackstone private equity investment fund limited partnerships and affiliated entities. Approximately 50% of the investors in the Blackstone funds were US citizens or

[1] Agreed Facts at paras 3, 7, and 13 (**Appellant's Record Tab 10**); Reasons for Judgment of the Tax Court of Canada (TCC Reasons) at para 10 (**Appellant's Record Tab 2**).

residents, and the remainder were not.[2] The Blackstone limited partnerships were originally established in Delaware but were later moved to the Cayman Islands.[3]

9. Alta Resources and Blackstone ultimately decided to invest in the Duvernay shale oil formation in Alberta. In June 2011, Alta Energy Partners Canada Ltd. (Alta Canada) was incorporated as a wholly-owned subsidiary of Alta US.[4]

10. From June 2011 to April 2012, Alta Canada acquired rights to drill for, and to recover, oil and natural gas in certain lands in Alberta.[5] Alta Canada financed those acquisitions with capital contributions from Alta US, and with advances directly from Alta Investments and Blackstone. Alta Canada issued promissory notes totalling $161,920,621 (the Interim Period Notes) in respect of those advances.[6]

11. By late 2011, it was expected that the value of Alta Canada would increase by $300 to $400 million over the next two years.[7]

2. ***Restructuring and transfer of the investment to Luxembourg***

12. The shares of Alta Canada were "taxable Canadian property" under the *Income Tax Act*[8] (the ITA) because more than 50% of their value was derived from Canadian resource properties.

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[2] Agreed Facts at paras 6-9 and 13 (**Appellant's Record Tab 10**); TCC Reasons at para 14 (**Appellant's Record Tab 2**).

[3] Trial testimony of Chaim Miller, managing director of Blackstone Capital Partners, p 319 line 10 to p 320 line 18 (**Appellant's Record Tab 57**).

[4] Agreed Facts at para 19 (**Appellant's Record Tab 10**); TCC Reasons at para 13 (**Appellant's Record Tab 2**).

[5] Agreed Facts at paras 31, 37, and 44 (**Appellant's Record Tab 10**); TCC Reasons at paras 13 and 26 (**Appellant's Record Tab 2**).

[6] McCarthy Tétrault PowerPoint presentation March 16, 2012 (**Appellant's Record Tab 25**); also Written Resolutions of the Board of Managers of Alta Luxembourg Sarl April 19, 2012 (**Appellant's Record Tab 29**).

[7] FCA Reasons at para 7 (**Appellant's Record Tab 4**); TCC Reasons at para 20 (**Appellant's Record Tab 2**).

[8] RSC 1985, c 1 (5th Supp), as amended.

Under paragraph 2(3)(c) and section 115 of the ITA, a non-resident's capital gain from disposing of taxable Canadian property is taxable in Canada unless exempted by a tax treaty.[9]

13. In 2011, Alta Resources and Blackstone were advised of this exposure to Canadian tax in relation to the Alta Canada shares, and that it could be avoided. A foreign holding company in Luxembourg was specifically recommended to them:

> The investment into Canada can be structured so that on an exit the investors are not subject to Canadian tax on a sale of shares of the Canadian corporation. Although Canada generally reserves the right to tax capital gains realized by a non-resident on the sale of the Canadian corporation carrying on an oil and gas business in Canadian [sic] some income tax treaties provide for an exemption from those treaties. Unfortunately, the Canada-US income tax treaty does not. Consequently, US private equity firms investing in private Canadian oil and gas companies typically do so through a third country with a more favourable treaty and where the third country entity is disregarded for US purposes, typically a Netherlands co-op or a Luxembourg SARL.[10] [emphasis added]

14. On April 19, 2012, Alta Resources and Blackstone restructured their Canadian investment to replace Alta US as the shareholder of Alta Canada with a new Luxembourg holding company still controlled by the same shareholders.[11] Alta Energy Luxembourg S.A.R.L. (Alta Luxembourg) was formed under the laws of Luxembourg with a total capital contribution of $18,000.[12] The shares of Alta Luxembourg were issued to a new Canadian partnership formed in Alberta, Alta Energy Canada Partnership (the Partnership). The shareholders of Alta US became the partners of the Partnership.[13] Alta US then transferred the Alta Canada shares to Alta Luxembourg.[14]

15. The shares of Alta Canada were transferred to Alta Luxembourg for a note of $55,335,693 (the Luxco Note). This amount reflected the value of Alta Canada's assets ($217,256,314)

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[9] FCA Reasons at paras 11-14 (**Appellant's Record Tab 4**); ITA ss. 2(3)(c), 115(1)(b) and 248(1) ("taxable Canadian property" and "treaty-protected property").
[10] FCA Reasons at para 7 (**Appellant's Record Tab 4**); and email from E Gill to A Acconcia and D Flaman sent June 1, 2011 (**Appellant's Record Tab 18**);
[11] FCA Reasons at para 9 (**Appellant's Record Tab 4**); TCC Reasons at paras 22-23 (**Appellant's Record Tab 2**).
[12] Deed of incorporation of Alta Energy Luxembourg Sarl (**Appellant's Record Tab 27**).
[13] FCA Reasons at para 9 (**Appellant's Record Tab 4**).
[14] FCA Reasons at para 8 (**Appellant's Record Tab 4**).

less the Interim Period Notes ($161,920,621). Alta US subsequently distributed the Luxco Note to the Alta and Blackstone shareholders as a return of capital.[15]

16. Subsequently, Alta Investments and Blackstone transferred the Interim Period Notes and the Luxco Note, totalling $217,256,314, to the Partnership.[16]

17. The Partnership then transferred the Interim Period Notes and the Luxco Note to Alta Luxembourg, taking back interests under two financing arrangements plus some shares:

    a. a Profit Participating Facility Agreement (PPL), under which Alta Luxembourg borrowed $184,683,166 from the Partnership;

    b. an Interest-Free Loan Facility (IFL), under which Alta Luxembourg borrowed $30,418,404 from the Partnership; and

    c. additional shares of Alta Luxembourg in the amount of $2,154,744.[17]

18. Under the PPL, interest on the outstanding principal accrued in favour of the Partnership and included a profit-sharing interest (Variable Interest) and an ordinary interest (Fixed Interest). The Fixed Interest accrued at a rate of 0.5% of the principal amount of the loan per year. The Variable Interest corresponded to 100% of the annual net profit of Alta Luxembourg, less any Fixed Interest paid and a margin of 1%.[18] (The Variable Interest could also be reduced by any amount that Alta Luxembourg's managers determined to retain in Luxembourg, but

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[15] McCarthy Tétrault PowerPoint presentation March 16, 2012 (**Appellant's Record Tab 25**); also Written Resolutions of the Board of Managers of Alta Energy Luxembourg Sarl April 19, 2012 **(Appellant's Record Tab 29)** and TCC Reasons at para 25 (**Appellant's Record Tab 2**).
[16] McCarthy Tétrault PowerPoint presentation March 16, 2012 (**Appellant's Record Tab 25**); and Written Resolutions of the Board of Managers of Alta Energy Luxembourg Sarl April 19, 2012 (**Appellant's Record Tab 29**).
[17] Agreed Facts at para 65 (**Appellant's Record Tab 10**); also Written Resolutions of the Board of Managers of Alta Energy Luxembourg Sarl April 19, 2012 (**Appellant's Record Tab 29**).
[18] Agreed Facts at para 64 (**Appellant's Record Tab 10**); Profit Participating Facility Agreement April 19, 2012 (**Appellant's Record Tab 28**).

no such amounts were ever considered).[19] The net effect of the PPL was to require Alta Luxembourg to pay virtually all profit (including capital gains) to the Partnership.

19. Prior to the restructuring, Blackstone's counsel obtained a ruling from the Luxembourg tax authorities confirming that either (a) any gain on the Alta Canada shares would be exempt from Luxembourg tax, or (b) amounts paid by Alta Luxembourg to the Partnership under the PPL would be deductible.[20]

20. The PPL and the IFL were subsequently amended and the loan amounts increased.[21] Between July 2012 and July 2013, the Partnership advanced additional funds totalling approximately $75,000,000. 99% of those amounts were recorded as draw downs by Alta Luxembourg under the PPL and the IFL, and 1% was recorded as a capital contribution by the Partnership. The entire $75,000,000 was then recorded as a subscription by Alta Luxembourg for additional Alta Canada shares.[22]

21. In addition, in January 2013 Alta Luxembourg transferred the Interim Period Notes to Alta Canada as another subscription for shares. The Interim Period Notes were then settled by operation of law.[23]

22. Alta Luxembourg retained a Luxembourg corporate services company to provide various corporate administration, accounting, and tax compliance services.[24] Alta Luxembourg had

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[19] Agreed Facts at para 64 (**Appellant's Record Tab 10**); Trial testimony of Joseph Greenberg, CEO of Alta Resources and member of Alta Luxembourg's Board of Managers, p 291 line 22 to line 26 (**Appellant's Record Tab 56**) (Appeal Book, vol. 13, p. 3934).
[20] Agreed facts, at para 51 (**Appellant's Record Tab 10**); Letter from Mr. Fort to Andrew Kurth LLP January 30, 2012 (**Appellant's Record Tab 21**).
[21] Alta Luxembourg Board of Managers meeting minutes November 19, 2012 (**Appellant's Record Tab 31**).
[22] Irrevocable Directions July 16, August 21, August 30, and November 14, 2012 (**Appellant's Record Tab 48**); Alta Luxembourg Board of Managers meeting minutes November 19, 2012 and April 12, April 30, and July 30, 2013 (**Appellant's Record Tabs 31, 33, 34, and 36**).
[23] Alta Luxembourg Board of Managers meeting minutes January 24, 2013 (**Appellant's Record Tab 32**); McCarthy Tétrault PowerPoint presentation March 16, 2012 (**Appellant's Record Tab 25**).
[24] Agreed Facts at para 67 (**Appellant's Record Tab 10**); Corporate Services Agreement (**Appellant's Record Tab 30**).

no employees or officers in Luxembourg. It also did not have an office, a dedicated phone line, a fax line, or an email address in Luxembourg.[25]

3. Exit from Canada and disposition of Alta Canada

23. In February 2013, Blackstone and Alta Resources began to explore the possibility of selling Alta Canada's shares. In June 2013, Chevron Canada Ltd. submitted a bid and shortly afterward an agreement was reached.[26] When the sale closed on September 10, 2013, Chevron paid approximately CDN $680 million.[27]

24. Alta Luxembourg did not receive any of the sale proceeds. Instead, $48,318,680.14 was remitted to the Minister of National Revenue (the Minister) as a withholding tax payment (for which Alta Luxembourg later claimed a refund) and the balance of the proceeds went directly to the Partnership.[28] The Partnership distributed those funds directly to its partners.[29]

25. Upon receipt of the sale proceeds, the Partnership issued promissory notes to Alta Luxembourg. Alta Luxembourg offset those notes against its financing liability to the Partnership under the PPL and the IFL, leaving only $10,000 outstanding.[30] After those offsets, Alta Luxembourg held notes of $7 million. Alta Luxembourg created a US branch and allocated the promissory notes to it, so that interest would not be taxed in Luxembourg.[31]

26. Following the disposition of Alta Canada, Alta Luxembourg did not conduct any other business or hold any other investments.[32]

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[25] Answer to discovery undertaking nos. 30, 32, and 33 – Joseph Greenberg (**Appellant's Record Tab 53**); Answer to discovery undertaking no. 22 – Angela Acconcia (**Appellant's Record Tab 54**).
[26] Agreed Facts at paras 96-105 (**Appellant's Record Tab 10**).
[27] Agreed Facts at paras 107 and 110 (**Appellant's Record Tab 10**).
[28] Agreed Facts at paras 110, 111, 113, and 114 (**Appellant's Record Tab 10**).
[29] Answer to discovery undertaking no. 46 – Joseph Greenberg (**Appellant's Record Tab 53**).
[30] Agreed Facts at paras 111, 114, and 115 (**Appellant's Record Tab 10**); Repayment Agreements dated Sept. 10, 2013 and Feb. 12, 2014 (**Appellant's Record Tabs 42 and 44**).
[31] Agreed Facts at paras 112 and 116 (**Appellant's Record Tab 10**).
[32] Agreed Facts at para 117 (**Appellant's Record Tab 10**).

4. The capital gain and Alta Luxembourg's claim to a treaty exemption

27. Alta Luxembourg recorded a capital gain of more than $380 million on disposing of the Alta Canada shares. In a Canadian tax return filed for the 2013 taxation year, Alta Luxembourg claimed an exemption from Canadian tax on the basis that the gain was not included in its "taxable income earned in Canada" under paragraph 115(1)(b) of the ITA because the shares were "treaty-protected property".[33] Alta Luxembourg relied on Articles 13(4) and (5) of the *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* (the Convention) to claim that the shares were treaty-protected property.[34]

28. The Minister assessed Alta Luxembourg to deny the treaty exemption. Alta Luxembourg appealed to the Tax Court of Canada.[35]

5. The Tax Court of Canada decision

29. Before the Tax Court, the Crown argued that Alta Canada did not "carry on business in" the immovable property at issue (the oil and gas leases and licenses), such that the "carve-out" from Canadian source taxation of Alta Luxembourg's gain under Article 13(4) of the Convention did not apply. In the alternative, the Crown relied on the GAAR.[36]

30. The trial judge found that Alta Canada carried on business in the immovable property and, as a result. the carve-out in Article 13(4) applied such that Alta Canada's shares were treaty-protected property for purposes of the ITA.[37]

31. With respect to the GAAR, Alta Luxembourg conceded that the entire 2012 restructuring sequence was an avoidance transaction that resulted in a tax benefit: the exemption from Canadian tax of the $380 million capital gain on the disposition of the Alta Canada shares.[38]

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[33] FCA Reasons at para 10 (**Appellant's Record Tab 4**).
[34] 10 September 1999, Can TS 2000/22.
[35] TCC Reasons at paras 1-2 (**Appellant's Record Tab 2**).
[36] TCC Reasons at paras 2-7 (**Appellant's Record Tab 2**).
[37] TCC Reasons at paras 68-69 (**Appellant's Record Tab 2**).
[38] Agreed Facts at para 125 (**Appellant's Record Tab 10**).

An equivalent exemption would not have been available under the Canada-US tax treaty if Alta US had been the direct vendor of the shares.[39]

32. The only GAAR issue before the Tax Court was whether the avoidance transaction resulted in a misuse or abuse of the provisions of the ITA or of the Convention. The trial judge found no abuse of either.[40]

33. In conducting the abuse analysis under subsection 245(4) of the ITA, the trial judge acknowledged the two-part inquiry established by this Court's GAAR jurisprudence.[41] The trial judge held that, as an international convention, a tax treaty should be given a liberal interpretation with a view to implementing the true intention of the parties.[42] He construed the "carve-out" from source state taxation under Article 13(4) of the Convention as an incentive to encourage investment by Luxembourg residents in immovable property in Canada for use in a company's business,[43] and then held that since that happened in this case the GAAR did not apply.[44]

6. __The Federal Court of Appeal decision__

34. The Federal Court of Appeal held that the rationale underlying Articles 1, 4, 13(4), and 13(5) of the Convention was fully expressed in their text.[45] The court held that the treaty provisions "operated as intended" because Alta Luxembourg was a resident of Luxembourg and so it was entitled to claim the benefit of the treaty. Therefore, there was no abuse.[46] The court did not attempt to describe the "result" of the series of transactions as required under the second step of the two-part abuse inquiry, or compare it with the rationale of those provisions.

35. In conducting its object, spirit, and purpose analysis, the Federal Court of Appeal declined to consider commentaries to the OECD Model Tax Convention (the OECD Model) because

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[39] Agreed Facts at para 124 (**Appellant's Record Tab 10**).
[40] TCC Reasons at paras 74 and 100 (**Appellant's Record Tab 2**).
[41] TCC Reasons at paras 71-72 (**Appellant's Record Tab 2**).
[42] TCC Reasons at para 64 (**Appellant's Record Tab 2**).
[43] TCC Reasons 40, 41, 43, 67-68, and 79 (**Appellant's Record Tab** 2).
[44] TCC Reasons at para 100 (**Appellant's Record Tab 2**).
[45] FCA Reasons at paras 66-70 and 73 (**Appellant's Record Tab 4**).
[46] FCA Reasons at para 80 (**Appellant's Record Tab 4**).

those commentaries related to a model created after Canada and Luxembourg had first negotiated the Article 13(4) carve-out provision in a prior convention.[47]

PART II – ISSUES

36. This appeal raises the following issues for decision by this Court:

    a. Did the Federal Court of Appeal err in law in equating the object, spirit, and purpose of the relevant treaty provisions with their textual meaning?

    b. Did the Federal Court of Appeal err in law and in fact in concluding that the avoidance transactions in this case did not result in an abuse of the relevant treaty provisions?

PART III – ARGUMENT

A. <u>Introduction</u>

1. <u>The analytical framework of the GAAR</u>

37. The GAAR permits the courts to negate an arrangement resulting in a tax benefit that would otherwise be permissible under a literal interpretation of the relevant provisions, where the transaction(s) resulting in the tax benefit is abusive.[48]

38. It is well-established that the GAAR applies when three conditions are met:

    a. there must be a "tax benefit" within the meaning of subsection 245(1) of the ITA;

    b. the tax benefit must result from an avoidance transaction (a transaction not undertaken primarily for a *bona fide* non-tax purpose), or from a series of transactions that includes an avoidance transaction (subsections 245(2) and (3)); and

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[47] FCA Reasons at para 36 (**Appellant's Record Tab 4**).
[48] *Canada Trustco Mortgage Co v Canada,* [2005] SCC 54 at para 13 [*Canada Trustco*].

c. the avoidance transaction or series must result, directly or indirectly, in an abuse of the relevant statutory provisions (subsection 245(4)).[49]

39. The existence both of a tax benefit and of an avoidance transaction is admitted in this case. The only remaining element of the GAAR analysis is the abuse inquiry. This Court has previously established a two-step abuse analysis. The first step is to apply a textual, contextual, and purposive approach to the relevant provisions in order to determine their object, spirit, and purpose. The second step is to examine the facts of the case in order to determine whether the overall result achieved by the transactions at issue defeats or frustrates that object, spirit, and purpose.[50]

40. In the GAAR context, the object, spirit, and purpose of provisions refers to the legislative rationale that underlies specific or interrelated legislative provisions. The rationale explains why the provisions were put in place and why the benefit was conferred.[51]

41. The GAAR abuse analysis requires more than simply a textual-focused interpretation. The GAAR operates when a taxpayer has otherwise complied with the literal meaning of the relevant provisions. It is only by identifying the "why" for the statutory provisions that a court can determine whether obtaining a particular tax benefit is abusive. Therefore, the textual, contextual, and purposive analysis under the GAAR can lead to different results from that obtained by traditional statutory interpretation focused on the meaning of a provision.

42. For purposes of the GAAR analysis, the relevant provisions include not just the provision(s) relied on for the tax benefit itself, but also other provisions that form part of an integrated statutory scheme. Provisions that operate together or in sequence to result in a tax benefit comprise the relevant scheme to be examined in the abuse analysis.[52]

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[49] ITA, ss 245(2), (3), and (4); *Canada Trustco* at para 17; *Mathew v Canada,* [2005] SCC 55 at para 31; *Copthorne Holdings Ltd v Canada,* 2011 SCC 63 at para 33 [*Copthorne Holdings*].
[50] *Copthorne Holdings* at paras 69-71; *Canada Trustco* at paras 44 and 55; *Lipson v Canada,* 2009 SCC 1 at para 34 [*Lipson*].
[51] *Canada Trustco* at para 66-4; *Copthorne Holdings* at para 70; *Canada v Oxford Properties Group Inc,* 2018 FCA 30 at paras 44-45 [*Oxford Properties*].
[52] *Lipson* at paras 34-37; *Copthorne Holdings* at para 91.

43. Once the object, spirit, and purpose of the relevant provisions is determined, the second step of the abuse analysis is to determine whether the result of the transactions is consistent with that object, spirit, and purpose, or whether it defeats, circumvents, or frustrates that object, spirit, and purpose.[53] This step of the analysis is necessarily fact-intensive.

44. Where a tax benefit results from a series of transactions, it is appropriate to consider the entire series and the overall result achieved by the taxpayer from undertaking the series. The analysis is not restricted to examining individual transactions in isolation or at a particular time.[54] Motivation, purpose, and economic substance are relevant to the abuse analysis when they establish whether the transactions frustrate the rationale of the relevant provisions.[55]

45. A finding of abusive tax avoidance is warranted where: (i) the transactions achieve an outcome that the statutory provision(s) was intended to prevent; (ii) the transactions defeat the underlying rationale of the provision; or (iii) the transactions circumvent the provision in a manner that frustrates its object, spirit, or purpose. These considerations are **not** independent ofone another and they may overlap.[56] Abusive tax avoidance may also be found whererelationships and transactions are "wholly dissimilar" to the relationships or transactionscontemplated by the provisions.[57] At all times, the overriding question is whether allowingthe tax benefit is consistent with the object, spirit, or purpose of the relevant provisions.[58]

2. The standard of review and errors by the Federal Court of Appeal

46. The applicable standard of review for the first step of the abuse analysis is correctness.[59] The object, spirit, and purpose of the relevant provisions giving rise to a tax benefit is an extricable question of law.

[53] *Canada Trustco* at paras 44-45 and 55; *Copthorne Holdings* at paras 71-72.
[54] *Lipson* at paras 34 and 37.
[55] *Canada Trustco* at paras 57-60; *Lipson* at para 38; also see Jinyan Li, "The Misuse and Abuse Exception: The Role of Economic Substance" in Brian J Arnold, ed, *The General Anti-Avoidance Rule: Past, Present, and Future* (Toronto: Canadian Tax Foundation, 2021) (forthcoming). (**Appellant's Book of Authorities [ABOA] Tab 18**)
[56] *Copthorne Holdings* at para 72.
[57] *Canada Trustco* at para 60.
[58] *Canada Trustco* at para 45.
[59] *Canada Trustco* at para 44; *Oxford Properties* at para 39; *Housen v Nikolaisen,* 2002 SCC 33 at para 8 [*Housen*].

47. The determination of whether an avoidance transaction results in an abuse having regard to the object, spirit, and purpose of the relevant provisions is a question of mixed law and fact. The applicable standard of review is normally palpable and overriding error.[60] However, where a lower court does not correctly identify the object, spirit, and purpose of the relevant provisions, its conclusion that there is no abuse is directly affected and an appellate court will conduct this analysis afresh.[61]

48. In this case, the Federal Court of Appeal erred in law in the first step of the abuse analysis. That court accorded no weight to contextual and purposive factors and conflated the object, spirit, and purpose of the Convention provisions with their text. The court did not conduct a proper textual, contextual, and purposive analysis of the relevant provisions of the Convention, namely Articles 1, 4, and 13. The court failed to acknowledge the unique nature of tax treaties and their purposes, and to read the relevant Articles in their proper context and coherently with the scheme of the Convention provisions that allocate taxing rights as between Canada and Luxembourg.

49. A proper textual, contextual, and purposive analysis of the relevant Convention provisions makes the rationale of the "distributive" provisions of the Convention clear. The scheme of the Convention seeks to avoid double taxation situations by allocating taxing rights to the Contracting State to which the taxpayer and the income are more closely connected. This scheme reflects that the state to which a taxpayer and their income are more closely connected has a greater claim to tax them.

50. The Federal Court of Appeal then compounded its error by truncating the second step of its abuse analysis. The court did not consider the overall result of the avoidance transactions at issue. By focusing instead on whether the provisions operated as intended, the Federal Court of Appeal erroneously hewed to the approach employed in its prior decisions in *MIL (Investments) SA*[62] and *St Michael Trust Corp.*[63] Those decisions focused primarily on compliance with the text of the treaties and did not attempt to identify a rationale behind their

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[60] *Canada Trustco* at para 44; *Oxford Properties* at para 39; *Housen* at para 8.
[61] *Canada v 594710 British Columbia Ltd,* 2018 FCA 166 at para 64.
[62] *Canada v MIL (Investments) SA,* 2007 FCA 236, affirming 2006 TCC 460.
[63] *St Michael Trust Corp v Canada,* 2010 FCA 309, affirming 2009 TCC 450.

provisions. They led to a conclusion that a resident of a contracting state cannot abuse a treaty by claiming a benefit that is available to residents.

51. *MIL (Investments) SA* and *St. Michael Trust* are not consistent with this Court's more recent guidance in *Copthorne Holdings,* which is clear that in the GAAR context the focus is on the "why" behind the relevant provisions. This mandates a broader inquiry into the legislative rationale.[64] This Court has rejected the former approach.[65] In deciding *St. Michael Trust*, this Court declined to endorse the Federal Court of Appeal's GAAR reasoning.[66]

52. If the Federal Court of Appeal had conducted a proper second step abuse analysis, identifying the overall result of the avoidance transactions and evaluating them in light of the underlying rationale of the relevant Convention provisions, it would have concluded that the avoidance transactions in this case abused those provisions.

53. The overall result was that residents of third party states accessed Canada's tax treaty with Luxembourg through an intermediary in order to exempt a capital gain from resource properties situated in Canada from the Canadian-source taxation that otherwise would have applied. The intermediary lacked meaningful economic connections to Luxembourg that would, under the rationale of the Convention, give Luxembourg as the residence state a greater claim to tax that gain than Canada as the source state. The transactions used treaty provisions intended to avoid double taxation for residents of Canada and Luxembourg, in order to encourage trade and investment, to facilitate a tax-free disposition of a prior investment made by residents of what this Court, in *Crown Forest,* termed "stranger" states to the Convention.

54. In the result, the Federal Court of Appeal erroneously permitted an obvious treaty shopping transaction to succeed.

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[64] *Copthorne Holdings* at para 70.
[65] *Lipson* at paras 15, 32, 48, 66, and 77.
[66] *Fundy Settlement v Canada, 2012 SCC* 14 at para 19.

3. ***The GAAR applies to abuses of Canada's tax treaties***

55. The GAAR applies to tax benefits where the transactions resulting in those benefits abuse treaty provisions.

56. It has long been recognized by the international community that some uses of tax treaties can be abusive; concerns to that end have been raised consistently since at least the 1970s.[67] Moreover, since the early 2000s, when the Commentary to the OECD Model Tax Convention was amended to more comprehensively address tax avoidance and treaty abuse, this has been a central focus of the international community's attempts to strengthen the network of bilateral tax treaties.

57. The practice known as treaty shopping has been a source of particular concern to international organizations like the OECD and the United Nations, as well as to national governments, including Canada.[68] Treaty shopping, broadly understood, constitutes "a premeditated attempt to take advantage of the international tax treaty network and careful selection of the most favorable treaty for a specific purpose".[69] It is widely accepted that treaty shopping is one way—and according to OECD member states, is the most prevalent way—in which taxpayers can abuse bilateral tax treaties. [70]

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[67] 1977 OECD Model Tax Convention, Commentary to Article 1 at paras 7-10 (Paris: OECD, 1977) (**ABOA Tab 21a**); Organization for Economic Cooperation and Development, *Double Taxation Conventions and the use of Conduit Companies* (Paris: OECD, 1986) (**ABOA Tab 24**); 2003 OECD Model Tax Convention, Commentary to Article 1 at paras 9-9.4 (Paris: OECD, 2003) (**ABOA Tab 22**); OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, OECD/G20 Base Erosion and Profit Shifting Project Action 6: 2015 Final Report,* (Paris: OECD, 2015) [*BEPS Action 6 Final Repor*t]. (**ABOD Tab 20**)
[68] *BEPS Action 6 Final Report*, *supra* note 67, at para 2 of the Introduction (**ABOD Tab 20**); Canada, Department of Finance, *Consultation Paper on Treaty Shopping – the Problem and Possible Solutions* (Ottawa: August 12, 2013) [*2013 Consultation Paper*]. (**ABOD Tab 5**)
[69] H David Rosenbloom, "Tax Treaty Abuse: Policies and Issues" (1983) 15:3 Law and Policy in International Business 763 at 766, cited in David G Duff, "Tax Treaty Abuse and the Principal Purpose Test – Part I" (2018) 66:3 Can Tax J 619 at 623-624. (**ABOD Tab 8**)
[70] Niels Bammens & Luc De Broe, "Treaty Shopping and Avoidance of Abuse", in Michael Lang et al eds, *Tax Treaties: Building Bridges Between Law and Economics* (Amsterdam: International Bureau of Fiscal Documentation, 2010) 51 (**ABOD Tab 3**); David G Duff, "Responses to Treaty Shopping: A Comparative Evaluation", in Michael Lang et al eds, *Tax Treaties: Building Bridges Between Law and Economics* (Amsterdam: International Bureau of

58. In a recent article devoted to tax treaty abuse, Professor Duff explained treaty shopping in the following terms:

> …tax treaty shopping "necessarily involves deliberate measures either to become a resident of a contracting state in order to obtain treaty benefits that are available under one or more of its tax treaties with other states, or to access these treaty benefits indirectly by means of a legal entity that is resident in the contracting state." Examples include a tax-motivated change of residence shortly before the disposition of property in order to obtain a treaty exemption on the taxation of capital gains, and conduit arrangements whereby a resident of one state directs an investment through a legal entity in a third state in order to obtain treaty benefits under that state's treaty with the ultimate source state.[71]

59. Treaty shopping has been criticized on various policy grounds: it can affect the reciprocal nature of treaties concluded by the contracting states, thus undermining the fairness of their bargain; it reduces incentives for states to enter into bilateral tax treaties in the first place; and it leads to outcomes not intended by the contracting states, such as reduced taxation, the erosion of national tax bases, and even non-taxation.[72]

60. In *Crown Forest,* this Court denounced treaty shopping as "highly undesirable" and as "patently contrary" to the basis on which Canada cedes its taxing rights under a tax treaty.[73]

61. The GAAR has applied to abuses of Canada's tax treaties since its enactment in 1988. In concluding the Third Protocol to the Canada-US Convention on March 17, 1995, Canada declined to adopt a mutual limitation-on-benefits provision in its tax treaty with the United States, stating its intention to rely on the GAAR instead to combat treaty abuses.[74] In 2004, Parliament amended section 245 of the ITA and enacted section 4.1 of the *Income Tax*

Fiscal Documentation, 2010) 75 (**ABOA Tab 7**); *BEPS Action 6 Final Report, supra* note 67, at para 2. (**ABOA Tab 20**)

[71] Duff, *supra* note 69, at 623-624. (**ABOA Tab 8**)

[72] *Ibid* at 624-625. (**ABOA Tab 8**)

[73] *Crown Forest Industries v Canada,* [1995] 2 SCR 802 at para 52 [*Crown Forest*].

[74] Treasury Department Technical Explanation of the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital Signed at Washington, D.C. on September 26, 1980, as Amended by the Protocol Signed at Ottawa on June 14, 1983 and the Protocol Signed at Washington on March 28, 1984 at p 87 (with discussion of Third and Fourth Protocols).

Conventions Interpretation Act.[75] The amendments clarified that the GAAR has always applied to tax benefits obtained under Canada's tax treaties since its adoption.

62. The Government of Canada has taken further steps to combat perceived abuses of its bilateral tax treaty network. Those steps include proposing unilateral legislative measures to combat treaty shopping in the 2013 Budget;[76] participating in the OECD/G20 Base Erosion and Profit Shifting (BEPS) project which began in 2013;[77] becoming a signatory to the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*[78] (MLI) that resulted from the BEPS project; and implementing the MLI in domestic legislation effective December 1, 2019,[79] thereby modifying many of Canada's tax treaties in accordance with Action 6 of the BEPS project. Despite these subsequent steps, however, the GAAR and section 4.1 of the *Income Tax Conventions Interpretation Act* remain Canada's primary legislative response to tax treaty abuses.

B. Step one – the object, spirit, and purpose of the relevant provisions

63. The tax benefit in this case resulted from the combined operation of provisions of both the Convention and the ITA. The relevant provisions include subsections 2(3), 115(1), and 248(1) of the ITA, which give effect to treaty exemptions for Canadian tax purposes, as well as Articles 1 and 4 of the Convention, which establish a taxpayer's entitlement to claim benefits under the Convention, and Articles 13(4) and (5), upon which the respondent specifically based its treaty claim.

64. A textual, contextual, and purposive analysis of the relevant provisions establishes a rationale not fully expressed in their text. Under the ITA, Canada levies tax on non-residents who realize capital gains from the disposition of Canadian real estate and resource properties, unless Canada has agreed in a bilateral tax treaty not to levy tax. The provisions of the Convention that allocate taxing rights as between Canada and Luxembourg (the "distributive

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[75] *Budget Implementation Act, 2004, No. 2,* SC 2005, c 19, ss 52 and 60 (assented to May 13, 2005).
[76] Canada, Department of Finance, *Economic Action Plan 2013 – Jobs, Growth and Long-Term Prosperity,* (Ottawa: March 2013) at 373; *2013 Consultation Paper*, *supra* note 68. (**ABOD Tab 5**)
[77] David G Duff, "Tax Treaty Abuse and the Principal Purpose Test– Part 2" (2018) 66:4 Can Tax J 947 at 949. (**ABOD Tab 9**)
[78] 24 November 2016, Can TS 1019/26.
[79] *Multilateral Instrument in Respect of Tax Conventions Act,* SC 2019, c 12 (assented to June 21, 2019).

provisions") do so based on an established and internationally-accepted rationale—the degree of economic connection that gives a state a legitimate claim to levy tax. That rationale underlies numerous Articles of the Convention, including Articles 1, 4, and 13.

65. The rationale underlying Articles 1, 4, and 13 of the Convention is that, in relation to shares which derive their value principally from immovable property used in a company's business, the economic connection to the company's state of residence would normally outweigh the connection to Canada as the *situs* of the immovable property. In accordance with the OECD Model and its underlying rationale, the scheme of the Convention is then to accord taxing rights to the state of residence.

1. Tax treaties require a broad interpretive approach

66. By their nature, tax treaties raise unique interpretive issues that require a broader approach than domestic taxing statutes. A tax treaty is an international agreement negotiated between Canada and another state.[80] The provisions of a tax treaty therefore reflect a bargain negotiated between the two states.[81] The terms of the treaty reflect the parties' mutual intentions and shared understanding.

67. In *Crown Forest,* this Court held that a tax treaty should receive a liberal interpretation. The goal of the interpretive process is to ascertain and implement the "true intention" of the parties. Unlike domestic tax legislation, where the interpretive process is often dominated by precise and detailed statutory text, tax treaties are generally-worded instruments and an overly literal or legalistic approach to interpretation must be avoided.[82] In interpreting a tax treaty, therefore, contextual and purposive factors must receive considerable weight.

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[80] Brian Arnold, "The Interpretation of Tax Treaties: Myth and Reality" (2010) 64:1 Bulletin for International Taxation, 1-14 at 10. (**ABOA Tab 2**)
[81] David A Ward, QC, "Canada's Tax Treaties" (1995) 43:5 Can Tax J 1719 at 1727. (**ABOA Tab 30**)
[82] *Crown Forest* at para 43, citing *JN Gladden Estate v The Queen,* [1985] 1 CTC 163 (FCTD); Russell K Osgoode, "Interpreting Tax Treaties in Canada, the United States, and the United Kingdom" (1984) 17 Cornell Int'l LJ 255 at 256-257. (**ABOA Tab 25**)

68. In addition, the specific text of tax treaty articles—particularly those based on internationally-recognized models—is not typically the subject of intense negotiations.[83] The meaning and rationale of those articles is often found in the context and background to the model convention, including commentaries.[84] In addition, a broad range of other extrinsic materials is available to assist in interpreting tax treaties.[85]

69. Placing greater emphasis on context and purpose when interpreting a tax treaty accords with international legal principles and with established Canadian jurisprudence regarding treaty interpretation generally. Article 31 of the *Vienna Convention on the Law of Treaties*[86] (which codifies authoritative principles of customary international law) requires the terms of a treaty to be interpreted in light of their context and in light of the treaty's object and purpose.[87] Further, as this Court recognized in *Crown Forest,*[88] Articles 31 and 32 of the *Vienna Convention* permit reference to be made to a range of extrinsic materials regarding the interpretation and application of the treaty.[89]

70. In *Crown Forest,* this Court held that, when interpreting a tax treaty, contextual and purposive factors should always be considered.[90] The added emphasis on context and purpose is equally applicable in the GAAR analysis, where the goal is explicitly to "go behind" the literal meaning of the treaty provisions to identify their rationale.

2. ***The textual analysis of the relevant provisions***

a) ***The ITA taxes non-residents in respect of taxable Canadian property unless there is a treaty exemption***

71. A textual analysis of the relevant provisions makes clear that it is Canada's intention to tax capital gains realized by non-residents from Canadian real estate and resource properties.

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[83] Rebecca M Kysar, "Interpreting Tax Treaties" (2016) 101 Iowa L Rev 1387 at 1390 and 1417-1418. (**ABOA Tab 15**)
[84] *Ibid* at 1390 and 1410 (**ABOA Tab 15**); Duff, *supra* note 77, at 989-992. (**ABOA Tab 9**)
[85] Kysar, *supra* note 83, at 1418 and 1445 (**ABOA Tab 15**); Arnold, *supra* note 80, at 14. (**ABOA Tab 2**)
[86] 23 May 1969, Can TS 1980/37 [*Vienna Convention*].
[87] *Vienna Convention,* Art 31(1).
[88] *Crown Forest* at para 61.
[89] *Vienna Convention,* Arts 31(2) and (3), and 32.
[90] *Crown Forest* at paras 42-44.

This policy is expressed in the ITA and is reflected in provisions of the Convention (and other Canadian tax treaties) that preserve Canada's right to tax gains from immovable property situated in Canada. Canada's policy of taxing gains from Canadian real estate and resource properties is subject to specific exemptions granted under its bilateral tax treaties.

72. The concept of "taxable Canadian property" is a cornerstone of Canada's international tax policy.[91] Under subsection 2(3) of the ITA, a disposition of taxable Canadian property is one of three events that renders a non-resident of Canada liable to Canadian income tax in a taxation year.[92] A non-resident who disposes of taxable Canadian property will include any taxable capital gain or allowable capital loss in their "taxable income earned in Canada" for the year.[93] The only exception is if the property is "treaty-protected property".[94]

73. The definition of "taxable Canadian property" in the ITA reflects Canada's policy of taxing gains realized by non-residents from types of property that are closely connected to Canada, supporting Canada's right to tax.[95] Taxable Canadian property includes shares of the capital stock of a corporation if, at any time during the preceding 60-month period, more than 50% of their fair market value was derived, directly or indirectly, from real or immovable property situated in Canada, from Canadian resource properties, or from timber resource properties. The shares of both Alta Canada and the Alta Luxembourg were "taxable Canadian property".

b) The "carve-out" in Article 13(4) is a narrow exception to a broad policy of source state taxation in relation to gains from immovable property

74. Three provisions of the Convention are relevant in this case: Articles 1, 4, and 13.

75. Article 1 provides that the Convention applies to persons who are "residents" of either or both of Canada and Luxembourg.[96] This provision establishes the scope of the Convention:

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[91] ITA ss. 248(1) ("taxable Canadian property"); Alexander Smith and Jin Wen, "The Taxation of Taxable Canadian Properties," *2019 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2019), 11:1-55. (**ABOA Tab 27**)
[92] ITA ss 2(3).
[93] ITA ss 115(1)(b).
[94] ITA ss 248(1) ("treaty-protected property").
[95] Canada, House of Commons, Standing Committee on Finance, "Taxable Canadian Property", in *Third Report of the Standing Committee on Finance*, (Ottawa: September 1996) in Section 1.
[96] Convention, Art 1.

benefits may be claimed under the Convention by a person who is a resident of one of the contracting states, and those benefits are not available to residents of other states.

76. Article 4 defines "resident" for purposes of the Convention to include persons who qualify as "residents" under the laws of one of the contracting states.[97] As this Court held in *Crown Forest,* Article 4 clearly contemplates that a "resident" of a contracting state will be liable to the most comprehensive taxation imposed by that state.[98] Article 4 also excludes any person as a resident of a contracting state if that person is liable to tax in that state only in respect of income from sources in that state.

77. Finally, Article 13 of the Convention allocates the right to tax capital gains between Canada and Luxembourg.[99] The starting point is Article 13(5), which provides the default treatment for taxing capital gains under the Convention, and favors the state of residence. Exceptions in Articles 13(1) through (4) preserve source state taxing rights in specific circumstances.[100]

78. Article 13(1) is an important exception to Article 13(5). Article 13(1) preserves the right of the state of source to tax gains derived from immovable property situated in that state.

79. Article 13(4) extends the source state's right to tax direct gains from the alienation of immovable property to indirect gains when immovable property is held through an intermediate entity. Where immovable property is held by a company, gains from alienating the shares of that company will be taxable in the source state if the shares principally derive their value from immovable property situated in the source state. Article 13(4) is subject to various conditions and excludes from its scope property in which the business of the company is carried on (except for rental property).

80. Article 13(4) is not, therefore, primarily an exempting provision. Article 13(4) is a form of specific anti-avoidance rule. It ensures that the source state's right to tax gains derived from immovable property situated in that state extends to gains that are realized indirectly through

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[97] Convention, Art 4.
[98] *Crown Forest* at para 40.
[99] Convention, Art 13.
[100] Articles 13(2) and (3) are not engaged in this case.

a company.[101] The carve-out for property in which the company carries on business is, properly construed, a narrow exception to the anti-avoidance provision.

81. Thus, the textual analysis discloses a clear scheme for the taxation of capital gains realized by a resident of Luxembourg from immovable property situated in Canada. However, the textual analysis does not shed light on the underlying rationale for the treaty benefit and whether the carve-out from Canadian source taxation under Article 13(4) was intended to be available having regard to the avoidance transactions in this case. The answer to that inquiry requires a contextual and purposive analysis of the Convention.

3. ***The contextual analysis of the treaty provisions – the Convention allocates taxing rights based on economic connections to each contracting state***

82. The contextual analysis requires situating the Convention in its international legal context, and interpreting the relevant provisions in light of the scheme expressed in the Convention as a whole. The contextual analysis includes considering relevant extrinsic materials such as the OECD Model and its Commentaries, which assist in explaining that scheme and the underlying rationale. Neither the trial judge nor the Federal Court of Appeal conducted a proper contextual analysis.

a) ***The OECD Model Tax Convention and its Commentaries are interpretive aids of the highest importance***

83. The Federal Court of Appeal erred in law when it refused to consider Commentaries on the basis that they related to a model convention adopted after Canada and Luxembourg had originally negotiated the carve-out provision in Article 13(4) in their 1988 convention.

84. In *Crown Forest,* this Court endorsed the OECD Model as being of “high persuasive value” because it enjoys world-wide recognition in the application and interpretation of bilateral tax

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[101] J Li & F Avella, “Article 13: Capital Gains”, in *Global Tax Treaty Commentaries* (Amsterdam: International Bureau of Fiscal Documentation, 2020) at 12–13 (**ABOA Tab 16**); Stefano Simontacchi, “Immovable Property Companies as Defined in Article 13(4) of the OECD Model”, (2006) *Bulletin for International Taxation,* vol. 1, 29 at 29-30. (**ABOA Tab 26**)

conventions.[102] The OECD Model is of particular value when interpreting tax treaties based on that model itself.

85. Model conventions such as the OECD Model and the United Nations Model Double Taxation Convention are created to ensure consistency in the international tax treaty network. They encourage states to adopt a consistent framework for allocating taxing rights to resolve situations of double taxation according to a common rationale.[103] Those models are accompanied by commentaries intended to assist with interpreting and applying the treaty terms.[104] The OECD Council recommends that members of the OECD should conform to the Model "as interpreted by the Commentaries thereon and having regard to the reservations contained therein".[105]

86. The Commentaries published by the OECD shed light on the common intentions and expectations of the contracting states.[106] Subject to any observations registered by a contracting state, those Commentaries reflect the consensus view of OECD members as to the meaning of, and rationale behind, the various articles of the OECD model and bilateral tax conventions based on that model.[107]

87. The interpretive value of the OECD Commentaries extends also to Commentaries adopted or amended after a bilateral tax convention has been concluded. Since at least the publication of the 1977 OECD Model and Commentaries, the OECD Council has adopted an ambulatory approach to the application of the Commentaries.[108] The current Model provides that states

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[102] *Crown Forest* at para 55.
[103] 2017 OECD Model Tax Convention (Paris: OECD, 2017), Introduction to Commentary at para 3. (**ABOA Tab 23b**) (All references are to the 2017 Commentaries unless the specific wording of a prior Commentary is relevant).
[104] 2017 OECD Model Tax Convention, Introduction to Commentary at para 28. (**ABOA Tab 23b**)
[105] 2017 OECD Model Tax Convention, Introduction to Commentary at paras 2-3. (**ABOA Tab 23b**)
[106] Klaus Vogel, "Double Tax Treaties and Their Interpretation" (1986) 4 Int'l Tax & Bus Law 1 at 39-41. (**ABOA Tab 28**)
[107] 2017 OECD Model Tax Convention, Introduction to Commentary at paras 29-30 (**ABOA Tab 23b**); Kysar*, supra* note 83, at 1430 (**ABOA Tab 15**); Arnold, *supra* note 80, at 13. (**ABOA Tab 2**)
[108] 2017 OECD Model Tax Convention, Introduction to Commentary at paras 33-34 (**ABOA Tab 23b**); see also *Recommendation of the OECD Council Concerning the Model Tax Convention on Income and Capital,* C(97)/195/FINAL (23 October 1997).

should conform to the Model "as interpreted by the Commentaries thereon…as modified from time to time."[109] This is particularly true for amendments that are intended simply to clarify, not to change, the meaning of the Articles or of the Commentaries.[110]

88. Therefore, revised and updated Commentaries properly form part of the context of a pre-existing convention based on the OECD Model, so long as they represent a fair interpretation of the existing provision, and subject to any observations registered by a contracting state.[111]

89. International law also supports the application of subsequent Commentaries when interpreting and applying a pre-existing convention based on the OECD Model. Those Commentaries fall within either Article 31 or Article 32 of the *Vienna Convention,* and are properly considered as part of the context of the relevant treaty provisions or as a supplementary means of interpretation.[112]

b) The OECD Model and Commentaries establish a common rationale for Articles 1, 4, and 13 – tax treaties intend to allocate taxing rights to the state with which there is a greater economic connection

90. A careful contextual analysis of the relevant provisions of the Convention (Articles 1, 4, and 13), read in their full context and coherently with the scheme of the Convention, makes clear that their underlying rationale extends beyond their text. Contrary to the Federal Court of Appeal's conclusion, the text does not conclusively explain their rationale.

i. The theory of "economic allegiance" based on connections to each contracting state underlies the scheme of the Convention as a whole

91. Tax treaties do not impose tax or confer taxing jurisdiction on the contracting states. States enjoy original taxing jurisdiction as an incident of sovereignty. Instead, tax treaties relieve

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[109] 2017 OECD Model Tax Convention, Introduction to Commentary at para 3. (**ABOA Tab 23b**)
[110] 2017 OECD Model Tax Convention, Introduction to Commentary at para 35. (**ABOA Tab 23b**)
[111] *Prévost Car Inc v Canada*, 2009 FCA 57 at paras 9-12; Vogel, Klaus. "The Influence of the OECD Commentaries on Treaty Interpretation", *Bulletin – Tax Treaty Monitor*, December 2000, 612 at 612 and 616. (**ABOA Tab 29**)
[112] Arnold, *supra* note 80, at 5-8 (**ABOA Tab 2**; David A Ward, "The Role of the Commentaries on the OECD Model in the Tax Treaty Interpretation Process", *Bulletin – Tax Treaty Monitor*, March 2006, 97 at 98-99 (**ABOA Tab 31**); J. Avery Jones, "Treaty Interpretation", in *Global Tax Treaty Commentaries* (Amsterdam: International Bureau of Fiscal Documentation, 2019) at 35. (**ABOA Tab 12**)

from double taxation by allocating the right to tax as between the two contracting states, or by providing for relief from tax such as through lower rates of tax. The contracting states then implement their commitments through domestic law.[113] A tax treaty's "distributive" provisions resolve situations of juridical double taxation, which result when the state in which a taxpayer resides (the residence state) and the state in which the taxpayer's income arises (the state of source) both assert their jurisdiction to tax at the same time.[114]

92. The scheme of the OECD Model and Commentary is that, for each different category of income, taxing rights are allocated between the state of residence and the state of source based on which state appears to have the stronger connection with the relevant income. The OECD Model and Commentary support the conclusion that the scheme of the Convention is identical: it seeks to resolve the double taxation "contest" between the two contracting states by assigning taxing rights with respect to different categories of income to the contracting state with which the economic connection is greater. This rationale underlies the distributive scheme of the Convention as a whole as well as the specific provision in Article 13(4).

93. The degree of a taxpayer's connection to a state is globally accepted as a legitimate basis for imposing tax liability.[115] As a connecting factor, "residence" is generally accepted to represent the closest economic and social connection to the state.[116] Although a taxpayer may earn income from activities carried on outside their state of residence, it is that state that provides them with the "benefits" that equip them to do so (financial and human capital, a legal and economic infrastructure, education and social services, etc.). The residence state is also where a taxpayer typically consumes the fruits of their income.[117]

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[113] Vogel, *supra* note 106, at 22 (**ABOA Tab 28**); Richard L Reinhold, "What is Tax Treaty Abuse (Is Treaty Shopping an Outdated Concept)" (2000) 53 Tax Law 663 at 673. (**ABOA Tab 26**)
[114] 2017 OECD Model Tax Convention, Introduction to Commentary at para 1. (**ABOA Tab 23b**)
[115] Eric CCM Kemmeren, "Legal and Economic Principles Support Origin and Import Neutrality-Based over a Residence and Export Neutrality-Based Tax Treaty Policy", in Michael Lang et al eds, *Tax Treaties: Building Bridges Between Law and Economics* (Amsterdam: International Bureau of Fiscal Documentation, 2010) 237 at 246-248. (**ABOA Tab 13**)
[116] Canada, *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966-67), at 541 [*Carter commission*].
[117] Kemmeren, *supra* note 115, at 260-261. (**ABOA Tab 13**)

94. As Professor Krishna explains, the residential connection creates an obligation to contribute to the state through taxes:

> In developed countries, residence is the most popular form of legal status connecting a taxpayer to the country. The theory underlying residence as a connecting factor is that a person should owe economic allegiance to the country with which he, she, or it is most closely connected in economic and social terms. The obligation to pay tax based on residence derives from the principle that persons who benefit from their economic and social affiliation with a country have an obligation to contribute to its public finances.[118] (emphasis added)

95. By contrast, taxation based on source is an expression of a state's territorial jurisdiction to tax activities in its territory.[119] Source-based taxation presumes that income is connected to the *situs* of the income-earning activity such that the income owes some "allegiance" to the *situs* state and gives it a justifiable claim to levy tax.[120]

96. It is generally accepted that the preparation of the original OECD Draft Model Tax Convention, which was published in 1963, was influenced by work done for the Financial Committee of the League of Nations in the 1920s.[121] The scheme for allocating taxing rights between the contracting states was influenced by the theory of "economic allegiance" presented to the Fiscal Committee of the League of Nations in 1923.[122] The *Report on Double Taxation* (also known as the "Four Economists' Report") suggested that both the residence of the taxpayer and the *situs* of income are relevant in determining which state

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[118] Vern Krishna, *Fundamentals of Canadian Income Tax,* vol 1 (Toronto: Carswell, 2014) ch 3, at 3. (**ABOA Tab 14**)
[119] Krishna, *supra* note 118, at 3. (**ABOA Tab 14**)
[120] Kemmeren, *supra* note 115, at 262. (**ABOA Tab 13**)
[121] Vogel, *supra* note 106, at 10-11 (**ABOA Tab 28**); 2017 OECD Model Tax Convention, Introduction to Commentary at paras 4-7. (**ABOA Tab 23b**)
[122] Gijsbert W.J. Bruins, Luigi Einaudi, Edwin R.A. Seligman & Sir Josiah Stamp, *Report on Double Taxation Submitted to the Financial Committee Economic and Financial Commission*, League of Nations document no. E.F.S.73.F.19 (Geneva: League of Nations, April 5, 1923) [*Report on Double Taxation*]; D. Gutmann & S. Austry, "Article 1 – Persons Covered", in *Global Tax Treaty Commentaries* (Amsterdam: International Bureau of Fiscal Documentation, 2018) at 2 (**ABOA Tab 10**); Jinyan Li, Nathan Jin Bao & Huaning Li, "Value Creation: A Constant Principle in a Changing World" (2019) 67:4 Can Tax J 1107 at 1111-1115 (**ABOA Tab 17**); P. Johann Hattingh, "Article 1 of the OECD Model: Historical Background and the Issues Surrounding It", *Bulletin – Tax Treaty Monitor*, May 2003, 215 at 215-216. (**ABOA Tab 11**)

should have the greater claim to levy tax. In relation to different categories of income, one or the other would prevail as the stronger connecting factor.[123]

97. The scheme of the OECD Model reflects this rationale. Generally, the OECD Model assigns exclusive or residual taxing rights to the state of residence, subject to specific exceptions in favor of the source state.[124] Where the source state's taxing rights are preserved, the OECD Model typically makes them conditional and/or limited.[125] The conditions and limitations on source state taxation reflect that, although income generally has some economic connection to the source state, source states typically provide "benefits" to non-resident taxpayers only to a limited extent as compared to the benefits provided by residence states.[126]

ii. The "economic allegiance" rationale extends through Articles 1, 4, and 13 of the Convention, including the "carve-out" in Article 13(4)

98. The theory of "economic allegiance" also provides the rationale for why the benefits of a double taxation convention are available only to "residents" of the contracting states as provided under Articles 1 and 4.[127] Being a resident of a contracting state assumes that the taxpayer in question has a sufficient economic connection to their state of residence such that the residence state's claim to tax the income can compete with the source state's claim to tax that same income.[128]

99. From 1977 onward, the Commentaries to the OECD Model have explained that the Model is intended to apply to persons who are subject to a comprehensive liability to tax based on their degree of connection to the state concerned.[129] This is consistent with the tax policy concept that the close economic connection embodied by residency creates an allegiance that justifies the state extending its taxing jurisdiction over the taxpayer's world income. (In

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[123] *Report on Double Taxation*, *supra* note 122, at 22-25 and 39.
[124] 2017 OECD Model Tax Convention, Introduction to Commentary at para 19. (**ABOA Tab 23b**)
[125] 2017 OECD Model Tax Convention, Introduction to Commentary at paras 19-25.1. (**ABOA Tab 23b**)
[126] Li & Avella, *supra* note 101, at p 6. (**ABOA Tab 16**)
[127] Gutmann & Austry, *supra* note 122, at 2 (**ABOA Tab 10**); B. Obuoforibo, "Article 4: Resident", in *Global Tax Commentaries* (Amsterdam: International Bureau of Fiscal Documentation, 2019) at 6 (**ABOA Tab 19**); Hattingh, *supra* note 122, at 221. (**ABOA Tab 11**)
[128] Kemmeren, *supra* note 115, at 260. (**ABOA Tab 13**)
[129] 1977 OECD Model Tax Convention, Commentary to Article 4, para 3. (**ABOA Tab 21b**)

Canada's domestic tax law, for example, this policy is embodied in sections 2 and 3 of the ITA, which require residents of Canada to pay tax on their world income from all sources whether inside or outside Canada.)[130]

100. It is clear from the scheme of the OECD Model, including Articles 1 and 4, that the benefits of bilateral tax conventions are intended to be available only to persons who have sufficient substantive economic connections to one of the contracting states to qualify as a resident. It is only when those connections are present that the rationale of displacing source state taxing rights in favor of the residence state is applicable.

101. This rationale is frustrated when taxpayers of a third state access the bilateral convention indirectly through an intermediate entity interposed solely to obtain treaty benefits. A hallmark of treaty abuse, including abusive treaty shopping, is that the "resident" interposed in one contracting state in order to obtain treaty benefit lacks substantive economic connections to the state of residence.[131] Thus, abusive treaty shopping threatens to frustrate, circumvent, and defeat the rationale that income should be taxed in the jurisdiction with the greater economic connection, giving rise to a claim to its allegiance.

102. The same principle also underlies Article 13 and the carve-out in Article 13(4) of the Convention.[132] The scheme of Article 13 is to favor the state of residence with respect to capital gains, subject to specific exceptions that preserve the source state's taxing rights.[133] One of those exceptions is for gains deriving from immovable property. Generally, Articles 13(1) and (4) of the OECD Model reserve the right to tax direct and indirect gains from immovable property to the *situs* state.

103. Allocating primary taxing rights over capital gains from most forms of property to the state of residence is consistent with the economic allegiance principle.[134] The residence state is the state where capital is typically accumulated and consumed and the source state

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[130] ITA ss 2(1) and (2), and s 3.
[131] Bammens and De Broe, *supra* note 70, at 52. (**ABOA Tab 3**)
[132] Li & Avella, *supra* note 101, at 8-10. (**ABOA Tab 16**)
[133] *Ibid* at 6.
[134] *Ibid* at 9.

contributes little to a non-resident's investments in movable property.[135] By contrast, in the case of immovable property like land, mines, oil, wells, and industrial or commercial establishments, the origin of wealth is predominantly the *situs* of the property.[136] In relation to income and gains from that property, therefore, the scheme of the OECD Model allocates taxing rights to the source state.

104. The OECD Commentaries explain that taxing rights over income from immovable property are generally accorded to the source state because of the "very close connection between" immovable property and the state of source.[137] This logic applies both to income derived from immovable property and to capital gains from disposing of the immovable property itself. As a result, since the original Draft Model Tax Convention was prepared in 1963, the OECD Model has aligned the treatment of gains from immovable property with its treatment of immovable property generally.[138]

105. Article 13(4) generally, and the "carve-out" specifically, follow a similar logic and rationale. The carve-out represents an exception to the principle of source state taxation of indirect gains from immovable property. It reflects a presumption that the value of immovable property in which a business activity is carried on is driven more by the business activity and that the property is not simply a passive investment. Accordingly, the economic justification for source state taxation is weaker. This is supported by the OECD Commentaries, which specifically contemplate a business property exception to Article 13(4) for immovable properties such as mines and hotels.[139] Those types of properties are business premises whose business use likely contributes primarily to their value.

106. The rationale underlying the Article 13(4) carve-out also accords with the treatment of business income generally under the OECD Model. For example, under Article 7 business

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[135] *Ibid* at 9 and 37.
[136] *Ibid* at 9.
[137] 2017 OECD Model Tax Convention, Commentary to Article 6 at para 1. (**ABOA Tab 23d**)
[138] 2017 OECD Model Tax Convention, Commentary to Article 13 at paras 4 and 22 (**ABOA Tab 23f**), Commentary to Article 6 at para 1 (**ABOA Tab 23d**), and Commentary to Article 22 at para 2. (**ABOA Tab 23g**)
[139] 2017 OECD Model Tax Convention, Commentary to Article 13(4) at paras 28.5 to 28.7. (**ABOA Tab 23f**)

profits are normally taxable only in the taxpayer's state of residence unless the taxpayer has a permanent establishment in the other state, in which case business profits attributable to that establishment are taxable in the source state.[140] Article 7 reflects that, in the absence of permanent ties to the source state, it is the residence state that is effectively the *situs* for the things that make earning business profits possible. Once a business has a permanent presence in the source state, however, it begins to derive sufficient benefits from the source state's infrastructure to justify a limited degree of source state taxation.[141]

4. ***The purposive analysis – the Convention is intended to encourage economic relationships and trade and investment flows, but not tax avoidance***

a) The primary goals of bilateral tax treaties are economic

107. The principal goals of entering into bilateral tax treaties are economic: to encourage the growth of trade and investment flows between the contracting states.[142] Tax treaties seek to achieve this purpose by removing "tax impediments" to cross-border trade and investment.[143] Double taxation is the main such impediment that states seek to address.

108. Avoiding double taxation through the allocation of taxing rights among the contracting states is therefore a means to reach economic objectives. Other aspects of tax treaties also encourage the development of economic relations without creating tax impediments:

> …the purpose of a tax treaty is to promote the exchange of goods and services and movements of capital, technology and persons between contracting states. Therefore, a tax treaty contributes to the development of the economic relationship between these countries. This is done through several means. One of these means, which is often referred to as a separate purpose of a tax treaty but which is…actually only a means of promoting the exchange of goods and services and movements of capital, technology and persons between the contracting states, is the removal of double taxation. Other means are the prevention of tax avoidance and tax evasion,

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[140] 2017 OECD Model Tax Convention, Article 7(1). (**ABOA Tab 23a**)
[141] 2017 OECD Model Tax Convention, Commentary to Article 7 at para 11 (**ABOA Tab 23e**); Li & Avella, *supra* note 101, at 9. **(ABOA Tab 16)**
[142] 2017 OECD Model Tax Convention, Introduction to Commentary at para 1 (**ABOA Tab 23b**); *2013 Consultation Paper, supra* note 68 (see Introduction). (**ABOA Tab 5**)
[143] *Crown Forest* at paras 45-46; *Carter Commission*, *supra* note 116, at 567; Brian J Arnold, "An introduction to tax treaties" (2013), at paras 43-44; 2017 OECD Model Tax Convention, Introduction to Commentary at para 1 and Commentary to Article 1 at para 54. (**ABOA Tabs 23b and 23c**)

elimination of discriminatory taxation and tax revenue-sharing between contracting states.[144] (emphasis added)

109. Indeed, due to the importance of encouraging international trade and investment, most states provide unilateral relief from double taxation within their own domestic taxing systems even without a treaty commitment to do so.[145]

110. In addition to creating impediments to international economic relations through double taxation, tax considerations can create inappropriate incentives that distort international trade and investment flows. Therefore, it is also widely accepted that preventing tax evasion and tax avoidance assists the growth of international trade and investment.[146]

111. Concluding bilateral tax treaties is a step undertaken by many governments to attract foreign direct investment.[147] By shifting taxing rights from states which seek to attract foreign investment to states which host pools of capital available for investment, modern tax treaties encourage the growth of foreign direct investment (for many economies such as Canada, attracting inbound investment and encouraging outbound investment are both important policy goals). Although this shift appears to favor states that are exporters of capital, states seeking to attract capital can still realize significant economic benefits by limiting their taxing rights through bilateral treaties. Treaties can also signal a state's willingness to operate under internationally-accepted investment and tax rules.[148]

112. In addition to encouraging economic relations, bilateral tax treaties provide states with other benefits such as exchange of information provisions, protection for their residents from discrimination by treaty partners, procedures for resolving treaty disputes through mutual agreement between taxing authorities, and mutual assistance with tax administration.[149]

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[144] Kemmeren, *supra* note 115, at pp 243-244. (**ABOA Tab 13**)
[145] Fabian Barthel et al , "The Relationship between Double Taxation Treaties and Foreign Direct Investment", in Michael Lang et al, eds, *Tax Treaties: Building Bridges Between Law and Economics* (Amsterdam: International Bureau of Fiscal Documentation, 2010) 3 at 6 (**ABOA Tab 4**); *Carter Commission*, *supra* note 116, at 568.
[146] Arnold, *supra* note 143, at para 46. (**ABOA Tab 2**)
[147] Barthel et al, *supra* note 145**,** at 3. (**ABOA Tab 4**)
[148] *Ibid* at 3-5.
[149] 2017 OECD Model Tax Convention, Introduction to Commentary at para 26. (**ABOA Tab 23b**)

b) Tax treaties are not intended to provide opportunities for tax avoidance

113. Article 1 of the Convention is identical to Article 1 of the OECD Model. Article 1 of the OECD Model has remained unchanged from the original 1963 draft model.

114. The OECD Commentary to Article 1 has stated since at least 1977 that tax treaties are not intended to provide avenues for taxpayers to engage in tax avoidance:

> 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.[150]

115. The 1977 Commentaries also addressed the "improper use" of a convention. The Commentary to Article 1 recognized that taxpayers could exploit differences in tax levels between states and the tax advantages provided by various states' taxation laws. Notwithstanding that, however, OECD member states clearly considered that some uses of tax treaties would be improper or abusive:

> This would be the case, for example, if a person (whether or not a resident of a Contracting State) acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly.[151]

116. The 1977 example of an improper use of a tax treaty remains in the OECD Commentaries today.[152] In the years since, this theme has been repeatedly restated and made more explicit.

117. The OECD substantially revised the Commentary to Article 1 in 2003 to address the improper use of tax treaties more comprehensively. The 2003 revisions state that preventing tax avoidance is one of the purposes of tax treaties, and that tax treaties should be interpreted to deny treaty benefits with respect to abusive transactions.[153] In addition, the 2003 revisions included an agreement among OECD member states that states are not obliged to grant the benefits of a convention when arrangements constitute an abuse of its provisions. The revised 2003 Commentary confirmed OECD member states' position on the

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[150] 1977 OECD Model Tax Convention, Commentary to Article 1 at para 7. (**ABOA Tab 21a**)
[151] 1977 OECD Model Tax Convention, Commentary to Article 1 at para 9. (**ABOA Tab 21a**)
[152] 2017 OECD Model Tax Convention, Commentary to Article 1 at paras 55-56. (**ABOA Tab 23c**)
[153] 2003 OECD Model Tax Convention, Commentary to Article 1 at paras 7 and 9.1-9.4 (**ABOA Tab 22**); also see Brian J Arnold, "Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model", *Bulletin – Tax Treaty Monitor*, June 2004, 244 at 249 and 260. (**ABOA Tab 1**)

"guiding principle" that the benefits of a tax treaty should not be available where a main purpose for entering into a transaction is to secure a more favourable tax position, and obtaining that tax position in the circumstances would be contrary to the object and purpose of the relevant treaty provision.[154]

118. Since 2017, the OECD Commentary has provided that legal residency alone is not an automatic entitlement to all benefits under a tax treaty.[155] This revision was made in conjunction with the addition of a new article, Article 29, to the OECD Model. That article reflects a continuing intention on the part of OECD member states to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.[156]

119. Bilateral tax treaties are intended to comply with the international law requirement that treaty obligations be performed in good faith. This principle, known as *pacta sunt servanda,* stems from international customary law and is codified in the *Vienna Convention.*[157] It is inconsistent with the obligation of good faith for one treaty partner to enter into a treaty with the intention of eroding the legitimate taxing jurisdiction of its treaty partner by facilitating tax avoidance. This is particularly the case with respect to a convention based on the OECD Model. Parties to a convention based on a common model are assumed to understand the scheme and rationale and to have mutually agreed to so conduct themselves.

5. ***Conclusions on the object, spirit, and purpose of the relevant provisions and treaty shopping***

120. A careful textual, contextual, and purposive reading of the relevant provision reveals a discernable rationale behind the legislative scheme. The object, spirit, and purpose of the relevant provisions is the following:

   a. Canada intends to tax non-residents who derive capital gains from Canadian real property and resource properties subject to narrow exceptions in bilateral tax treaties;

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[154] 2003 OECD Model Tax Convention, Commentary to Article 1 at para 9.4. (**ABOA Tab 22**)
[155] 2017 OECD Model Tax Convention, Commentary to Article 1 at para 1. (**ABOA Tab 23c**)
[156] 2017 OECD Model Tax Convention, Commentary to Article 29 at para 1. (**ABOA Tab 23h**)
[157] *Vienna Convention,* Article 26.

b. Canada and its treaty partners enter into bilateral tax treaties for the purpose of fostering their economic relations by removing tax barriers to trade and investment flows, not to provide avenues for residents of other states to avoid their taxes;

c. under tax treaties based on the OECD Model, treaty benefits are intended to be enjoyed by persons with a substantial economic connection to their state of residence such that they owe economic allegiance to that state; and

d. tax treaties based on the OECD Model allocate taxing rights as between the contracting states based on the relative economic connection of the taxpayer and the income with the state of residence and the state of source.

121. The selection of a jurisdiction for the purpose of accessing benefits under its tax treaties can be abusive if it involves transactions that are disconnected from the economic logic underlying the inter-state bargain reflected in the treaty.[158] Transactions that lead to anomalous outcomes that frustrate, defeat, or circumvent the rationale underlying the allocation of taxing rights in the treaty, and which do not advance its goals and purposes, will be abusive. The contracting states would not have intended such transactions to benefit from the treaty. Hallmarks of abusive treaty shopping will include the use by third parties of an intermediate entity in a jurisdiction that lacks substantive economic connections that would give rise to economic allegiance to that jurisdiction.

122. When residents of third party states engage in abusive treaty shopping, they undermine the reciprocal relationship between the treaty partners. Canada agrees to cede its taxing rights in a treaty on the expectation that Canadian residents will receive benefits in return from the other contracting state. In addition, Canada and its treaty partner share an understanding as to the basis and rationale for when those benefits will be claimed by each other's residents.

123. When residents of a third state access Canadian treaty benefits indirectly, there is no reciprocity with that third state. In addition, the integrity of Canada's reciprocal bargains with each discrete treaty partner is eroded. Finally, Canada's ability to negotiate treaties is undermined. Other states will not have an incentive to offer benefits to Canadian residents

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[158] Luiza Brindusa Cruceru, *Treaty Shopping and the Abuse of Income Tax Conventions*, (Montreal: McGill University, 2005) at 95-97. (**ABOA Tab 6)**

in order to obtain Canadian tax benefits for their residents if their residents are already able to obtain Canadian treaty benefits indirectly.

C. Step two – the avoidance transactions are abusive treaty shopping

124. Because the Federal Court of Appeal erred in law in identifying the object, spirit, and purpose of the relevant provisions, this Court must conduct the second step of the abuse analysis afresh using the correct object, spirit, and purpose.

125. The avoidance transactions in this case can be summarized as follows. Prior to the avoidance transactions, the shares of Alta Canada (which were taxable Canadian property) were held by a U.S. entity (Alta US) for the benefit of shareholders who were residents of either the U.S. or of a non-treaty jurisdiction (the Cayman Islands). In order to negate the Canadian tax consequences of the disposition of those shares, ownership of the shares was transferred to Alta Luxembourg. However, the transfer was structured to ensure the flow-through nature of the arrangement. No gain was realized in Luxembourg and the sale proceeds were distributed to the same shareholders located in the U.S. and the Cayman Islands. But for those avoidance transactions, Canada would have been entitled to impose tax on the capital gain realized if Alta US had disposed of the Alta Canada shares.

126. The avoidance transactions achieved no commercial objective. They merely served to make the benefits of the Convention between Canada and Luxembourg indirectly available to residents of third party states to whom Canada did not directly grant equivalent treaty exemptions. Alta Luxembourg carried on no business activity other than holding the shares of Alta Canada. That fact, combined with financing arrangements that prevented Alta Luxembourg from realizing any gain in Luxembourg, removed the economic connection to Alta Luxembourg's state of residence that formed the basis of Canada's agreement to cede its right to tax this gain to Luxembourg. The avoidance transactions did not increase trade, investment, or the movement of capital, technology and persons between Canada and Luxembourg. Their sole purpose was to permit residents of stranger states to liquidate a pre-existing investment in Canada free of Canadian tax.

128. In particular, the following factual aspects of the transactions illustrate their abusive nature:

   a. Alta Luxembourg was created and controlled by entities not resident in Luxembourg, but in jurisdictions that do not have a tax treaty with Canada (the Cayman Islands), or whose tax treaty did not include the Article 13(4) carve-out (the United States).

   b. Alta Luxembourg was not a mechanism to make an investment or carry on business in Canada. It was a mechanism to avoid Canadian tax on liquidating a pre-existing investment.

   c. There was no real investment in Canada from Luxembourg. Except for $18,000, all $293,000,000 injected into Alta Luxembourg was loaned by the members of the Partnership. The majority of those funds were advanced directly to Alta Canada and only connected to Luxembourg by book entries.

   d. The financing transactions ensured that Alta Luxembourg could not derive an economic gain from the Alta Canada shares. The PPL and IFL created a virtually self-cancelling transaction where any gain accruing in respect of the Alta Canada shares was automatically matched by an equivalent liability to the Partnership. From an economic perspective, Alta Luxembourg had no value (since the shares of Alta Luxembourg were also taxable Canadian property under the ITA, this ensured that no gain would be realized on the ultimate disposition of those shares).

   e. 99% of the actual gain in respect of the Alta Canada shares was realized by Alta Investments and Blackstone through debt repayments by Alta Luxembourg under the PPL and the IFL. Chevron even paid the sale proceeds directly to Alta Investments and Blackstone. Alta Luxembourg only received a promissory note, which it then assigned to a US branch. Even the $48 million remitted to the Crown as withholdings will, if refunded, be realized 99% by Alta Investments and Blackstone.

   f. Alta Luxembourg had no economic or commercial ties to Luxembourg beyond retaining a corporate service provider and a nominee Board of Managers. After disposing of the Alta Canada shares, Alta Luxembourg did not carry on any other business or hold any other investments.

g. The transactions were structured so that Alta Luxembourg would not pay any tax in Luxembourg. The gain would either (a) be exempt from Luxembourg tax under an exemption for foreign share participations, or (b) be offset by deducting payments under the PPL and the IFL to the Partnership. The transactions achieved a "no taxation" outcome.

129. The avoidance transactions in this case are a classic example of treaty shopping and they result in an abuse of the provisions of the Convention. Those transactions defeat the underlying rationale of Articles 1, 4, and 13 of the Convention. They are wholly dissimilar to the relationships and transactions contemplated by the treaty provisions. They could not have been within the intentions of the drafters of the Convention.

130. On entering into the Convention with Luxembourg, it could not have been Canada's intention to provide an avenue for residents of other states, to whom Canada has deliberately elected not to extend the benefit of the Article 13(4) carve-out, to circumvent subsections 2(3) and 115(1) of the ITA. Canada did not intend to create, in effect, a lowest common denominator global tax treaty policy, or, in the words used by this Court in *Crown Forest,* to cede its taxing authority to a jurisdiction that is a stranger to the Convention. The result of these transactions is patently contrary to the basis on which Canada agreed to the Article 13(4) carve-out. It results in an abuse of the treaty provisions and it attracts the GAAR.

D. The reasonable tax consequence is to deny the benefit of Article 13(4)

131. Under subsection 245(2) of the ITA, where a transaction is an avoidance transaction, the tax consequences to the person must be determined as is reasonable in the circumstances so as to deny the resulting tax benefit.[159] The reasonable tax consequence in this case is to deny Alta Luxembourg the benefit of the carve-out in Article 13(4) of the Convention. The Alta Canada shares would not be treated as treaty-protected property for purposes of paragraph 115(1)(b) of the ITA and the taxable portion of the gain would be taxed as part of Alta Luxembourg's taxable income earned in Canada in the 2013 taxation year.

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[159] ITA, ss 245(2).

PART IV – COSTS

132. There is no reason to depart from the general principle that costs follow the cause. Canada requests its costs in this Court and in the courts below.

PART V – ORDER SOUGHT

133. Canada requests that the appeal be allowed and the judgment of the Federal Court of Appeal set aside. The respondent's appeal under the ITA in relation to its 2013 taxation year should be dismissed.

PART VI – SUBMISSIONS ON SENSITIVITY OF INFORMATION ON FILE

134. Not applicable.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

DATED at the City of Victoria, in the Province of British Columbia, this 7th day of December, 2020.

Michael Taylor
Natalie Goulard

Counsel for the appellant

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