

Important Court Ruling on Treaty Interpretation – Another Setback for the CRA

This commentary was prepared by Wilson & Partners LLP, a law firm affiliated with PricewaterhouseCoopers.

The Tax Court of Canada (TCC) decision in **Prévost Car Inc. v. The Queen** provides valuable guidance on how receptive the courts are likely to be when the Canada Revenue Agency (CRA) challenges some international structures.

In recent years the CRA has stated its intention to challenge international structures that result in reduced or nil withholding tax on dividends, interest or royalties from Canada, or other treaty benefits. Especially likely to attract attention are structures that involve an "intermediary company" that does not have significant activities or other assets.

The CRA argued unsuccessfully in **The Queen v. MIL (Investments) S.A.**¹, that a non-resident had engaged in abusive "treaty shopping" that was subject to the general anti-avoidance rule (GAAR) when he chose to hold certain Canadian assets through a Luxembourg company.

The CRA took a different approach in **Prévost**, arguing that a holding company established in a treaty jurisdiction (the Netherlands) was not the beneficial owner of the income in question (dividends). However, **Prévost** too was decided in favour of the taxpayer.

What happened?

In **Prévost**, a holding company had been established in the Netherlands by a U.K. company and a Swedish company (which were at arm's length) to hold the shares of a Canadian company in a joint venture arrangement. A shareholder agreement provided that, in principle, 80% of the profits of the jointly held companies (the Canadian operating company and the holding company) would be paid out each year as dividends to the U.K. and Swedish companies (which were 49% and 51% shareholders, respectively). On these grounds, the CRA argued that the Netherlands holding company was not the beneficial owner of the dividends received. The CRA's argument was based on the assertion that the holding company was simply a "conduit" or "funnel" for the dividends.

The TCC allowed the taxpayer's appeal, concluding that the relevant provisions of the Canada-Netherlands tax treaty required the TCC to look primarily to the domestic meaning of "beneficial ownership" in applying the dividend article. Implicitly, the TCC rejected the approach followed in at least one U.K. case, in which the court suggested that, when treaty interpretation is concerned, "beneficial ownership" has an "international fiscal meaning" different from its domestic law meaning. In **Prévost**, the TCC concluded that the dividends paid by the Canadian operating company to the Netherlands holding company were beneficially owned by the Netherlands holding company; the monies represented by the dividends were fully available to its creditors and until it in turn declared and paid a dividend, the funds continued to be its property.

1. 2007 CarswellNat 1719, 2007 FCA 236, 2007 D.T.C. 5437 (Eng.), [2007] 4 C.T.C. 235 (Federal Court of Appeal).

PwC Comments

The decision will have important implications for Canadian corporations that rely on the provisions of a tax treaty to reduce the withholding tax rate on dividends or other payments to a foreign holding company. The case is an important addition to the limited Canadian jurisprudence on treaty interpretation.

It will be interesting to see whether the CRA appeals the TCC's decision. Although the decision is a setback for the CRA, it serves as a reminder that the CRA is actively looking at international holding company structures and, accordingly, that taxpayers should exercise care when establishing and maintaining such structures.

For More Information

For more information on the implications of this decision, please contact your PricewaterhouseCoopers adviser or Wilson & Partners:

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