

Canada
International Tax

Contacts

National tax policy leader
Albert Baker
416-643-8753

National leader -
International Tax
Etienne Bruson
604-640-3175

Canadian Desk leader
Hong Kong
Chris Roberge
852-285 25627

Atlantic
Brian Brophy
709-758-5234

Quebec
François Champoux
514-393-5019

Ontario
Mark Noonan
613-751-6688

Tony Maddalena
905-315-5734

Toronto
Tony Ancimer
416-601-5945

Sandra Slaats
416-643-8227

Alberta and Prairies
Andrew McBride
403-503-1497

Charles Evans
780-421-3884

British Columbia
Brad Gordica
604-640-3344

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International tax alert

BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

September 22, 2014

On September 16, 2014, ahead of the G20 Finance Ministers' meeting on September 20-21, 2014, the OECD published seven papers as a first tranche of deliverables under the base erosion and profit shifting (BEPS) project, including one on Action 6, with respect to treaty benefits (particularly treaty shopping). The OECD will be continuing its work on the remainder of the 15 BEPS Actions throughout 2015. The G20 and OECD member governments intend that the recommendations under each of the Actions will form a comprehensive and cohesive approach to the international tax framework, through domestic legislation and international principles under the model tax treaty and transfer pricing guidelines. As a result, the proposed solutions in the first seven papers, while agreed to, are not yet finalized and may be affected by decisions and future work on BEPS in 2015.

Deloitte's comments on treaty abuse paper

The inclusion (albeit provisional) of the derivative benefits clause in the limitation on benefits (LOB) rules, together with the ability for competent authorities to override the rules where there is no evidence of abuse, are welcome developments. However, there will continue to be uncertainty for businesses seeking to determine whether the rules apply. It is also unclear whether or not Canada will proceed with its proposed domestic anti-treaty shopping legislation and how that legislation would interact with the OECD proposals, once finalized.

OECD proposals

Prevention of abuse: The new proposals are more flexible than the original proposals contained in the discussion draft of March 14, 2014. They provide that at a minimum, tax treaties should include either:

- (i) a principal purposes test (PPT);
- (ii) an LOB rule supplemented by a mechanism (which could include a domestic law provision or judicial doctrine) that would deal specifically with conduit arrangements; or
- (iii) a combined approach (i.e., include both PPT and LOB rules).

Certain targeted anti-avoidance clauses are also proposed, together with changes to the title, preamble and Commentary on the OECD Model Tax Convention to clarify that the prevention of tax evasion and avoidance, specifically including but not limited to treaty shopping, is one of the purposes of a double tax treaty.

LOB rule: Changes to the OECD proposals allow parties to include in treaties a specific anti-abuse rule based on the LOB provision already included in many US treaties. The rule is broadly designed to limit treaty benefits to companies with sufficient presence in the relevant country, based on their legal nature, ownership and activities. There are some new proposals, including optional clauses on the treatment of collective investment vehicles (CIVs), competent authorities' considerations for discretionary relief and the ability to take into account regional groups (e.g., the European Union) when drafting clauses.

LOB – derivative benefits clause: The LOB proposals provisionally include a “derivative benefits” clause, which would allow a treaty country to look through to the shareholders in certain cases where the shareholders would also be entitled to benefits under a treaty. Negotiating states would be given the flexibility to restrict the clause to dividend income. The inclusion of a derivative benefits clause is based on an assumption that other BEPS Actions will address specific concerns which may arise from its inclusion, and this will therefore be reexamined in 2015.

Principal purposes test: The paper proposes a broadly drafted general purpose test aimed at removing treaty benefits where one of the principal purposes of arrangements or transactions is to obtain treaty benefits.

Determining treaty residence: The existing “place of effective management” tie-breaker clause for determining treaty residence is to be replaced by a requirement that the competent authorities of the two countries endeavour to determine residence. Countries which share the view that the “place of effective management” rule was not being abused can continue to use it.

Minimum shareholding period re dividends: Reduced rates of withholding tax applicable to non-portfolio dividends will be restricted to shareholdings that are owned throughout a 365-day period that includes the date of the dividend payment, taking into account any internal reorganizations in the period.

Withholding taxes on payments to permanent establishments: Relief from withholding taxes on payments to a permanent establishment in a third country with a low rate of tax are proposed to be restricted where the permanent establishment's profits are exempt from tax in the resident country.

Timetable

Further work will be undertaken in 2015 to refine the proposals and, in particular, to further develop them in respect of the treatment of CIV and non-CIV funds.

Canadian anti-treaty shopping proposals

On August 29, the Canadian government announced that it would defer its 2014 budget proposals on treaty shopping pending further work by the OECD and G20 with respect to the BEPS initiative. It is unclear whether or not or when the budget proposals may be introduced now that the BEPS proposals are further advanced.

Comparison of the OECD and Canadian approaches

The approach to treaty shopping outlined by the OECD differs in many respects from that outlined by the Canadian government in the 2014 budget. The chart compares the two approaches.

Approach	OECD	Canada
Treaty vs. domestic	Treaty-based	Domestic law
Specific vs. general	New flexible approach allows specific LOB provision (with anti-conduit measure) or general PPT	General approach, supplemented by more-specific provisions (conduit presumption, safe harbour presumption)
One of main or principal purposes provision	PPT is one option, but not applicable where the granting of the benefit is in accordance with the object and spirit of the treaty	Yes, subject to the conduit presumption, the safe harbour presumption and a reasonableness exception; no object and spirit of the treaty exception
Qualifying person exception	Yes, included in the LOB provision	Limited; safe harbour presumption would apply for corporations and trusts the shares or units of which are regularly traded on a recognized stock exchange
Active trade or business exception	Yes, included in the LOB provision	Yes, included in the safe harbour presumption
Derivative benefits provision	Now included on a provisional basis, subject to other BEPS developments in 2015	Yes; safe harbour presumption would apply where the person is not controlled directly or indirectly by a person that would not have been entitled to equivalent treaty benefits, but subject to the conduit presumption
Relieving provision	Yes, competent authority relief	Yes; if the main purpose provision applies in respect of a benefit, the benefit is to be provided to the extent that it is reasonable having regard to all the circumstances

Deloitte resources

The upcoming Deloitte Dbriefs webcast will include a discussion of some of the recent OECD actions. We welcome you to [register](#).

In addition please refer to the Deloitte [BEPS site](#) which has useful resources and updates.

Albert Baker, Toronto

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2 Queen Street East, Suite 1200
Toronto, ON M5C 3G7 Canada

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