

Finding a Governing Law to Resolve Conflicts of Tax Laws

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A thesis submitted to the Faculty of Graduate Studies in partial fulfillment of the requirements
for the degree of Master of Law.

Graduate Program in Law
York University
Toronto, Ontario

August 2021

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Abstract

This thesis explores how tax treaty articles providing foreign tax recognition, distributive rules, meanings for undefined terms, and anti-treaty shopping rules implicitly employ conflict of laws “choice of law” (“COL/col”) principles to derive the governing law in situations where more than one tax law and therefore more than one legal system applies to characterize a person or income. COL/col principles are implicitly acknowledged and specifically operate in tax treaties to reconcile contending tax laws and therefore legal systems. Considering tax treaty articles implore countries to ascertain the governing law through reconciliation, supranational approaches that advocate harmonization to ascertain governing law are unnecessary. Reconciliatory approaches are preferable to harmonization approaches because the former supports countries’ law-making sovereignty and the latter does not.

Dedication

I dedicate this work to my friends and mentors at Bisbicus Law Corporation, Thompson Rivers University, the Supreme Court of British Columbia, the Tax Court of Canada, Osgoode Hall Law School, and Osgoode Professional Development (Tax), whose commitment to my growth as a lawyer and a person helped me to develop the skills to prepare this thesis.

Acknowledgements

I am grateful to my husband, Rob, for his loving support and unwavering confidence in me during this pursuit and every other one I have embarked on.

I am grateful to my supervisor, Professor J Scott Wilkie, for his belief in my thesis topic, generosity of knowledge, and kind understanding from start to finish.

I am grateful to the Social Sciences and Humanities Research Council of Canada, the Law Society of British Columbia, and York University, whose generosity allowed me to devote myself entirely to research during the 2020-2021 academic year.

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1 Introduction

The objective of this thesis is to show that tax treaties reconcile simultaneous, legitimate, divergent application of countries' domestic tax laws by latently employing conflict of laws "choice of law" ("COL/col") principles to ascertain the governing law for the tax treaty article applicable in the circumstances. Reconciliatory approaches latently employing COL/col principles are good because they acknowledge the inevitable encounter of countries' legal systems on the terrain of international taxation, anticipate diverse legal systems, and support countries' law-making sovereignty by permitting both legal systems to remain intact, unchanged, and unharmonized even though one of the contending legal systems prevails over the other contenders and applies in the circumstances. If the full extent of the heuristic utility of tax treaties' reconciliatory approach is understood, supranational law currently advocated by the Organisation for Economic Co-Operation and Development ("OECD") can be better understood as unnecessary and undesirable.

There is no "international tax system" within the conventional understanding of a 'legal system'.¹ Wilkie and Hogg write, "[t]he first 'rule' of international tax law is that there is no 'international tax law'".² This is, in part, as Ault and Bradford allude to, because there is no natural law of the location and therefore the right to tax income.³ There is no international tax law because there is no international tax law *system*, the operation of which effectuates enactment, enforcement, and adjudication of 'hard' law on the international stage.⁴ This is because the international tax environment is not bound together by, nor operates through the distinct, separate, and mutually-reliant functions of the key and core *systemic* features found in

¹ Scott Wilkie and Peter Hogg, "Tax Law Within the Larger Legal System" (2015) 52:2 OHLJ 460 at 478 [Wilkie and Hogg, "Tax Law Within the Larger Legal System"]; See also Hugh J Ault and David F Bradford, "Taxing International Income: An Analysis of the U.S. System and Its Economic Premises" in Assaf Razin and Joel Slemrod, eds., *Taxation in the Global Economy* (Chicago: University of Chicago Press, 1990) 11 at 31 [Ault and Bradford, "Taxing International Income"].

² Wilkie and Hogg, "Tax Law Within the Larger Legal System", *ibid* at 478.

³ Ault and Bradford, "Taxing International Income", *supra* note 1 at 31.

⁴ Many transnational and post-national theorists write about how "law" can be and is created *without* the presence of such structures: Kalypso Nicolaidis and Gregory Shaffer, "Transnational Mutual Recognition Regimes: Governance without Global Government," (2005) 68 L & Cont Prob 263; Peer Zumbansen, "Transnational Private Regulatory Governance: Ambiguities of Public Authority and Private Power," (2013) 76: 2 L & Cont Prob 117; Roger Cotterrell, "Transnational legal authority: a socio-legal perspective" in Roger Cotterrell & Maksymilian Del Mar, eds., *Authority in Transnational Legal Theory: Theorising Across Disciplines* (Northampton, MA: Edward Elgar Pub, 2016) 25; Keith Charles Culver and Michael Giudice, *The Unsteady State: General Jurisprudence for Dynamic Social Phenomena* (New York: Cambridge University Press, 2017) [Culver and Giudice, *The Unsteady State*].

other legal environments recognized as legal systems. In the Canadian context, such systemic features are the legislature, executive, and judiciary. There is no international legislature which passes international tax statutes through an agreed-upon process for legitimacy. There is no international tax authority wielding delegated power to enforce international tax statutes. There is no international tax court to adjudicate disputes that arise regarding the application of international tax statutes or the actions of an international tax authority.⁵ Unlike other areas of international law and notwithstanding the “constructive” international tax system that grew up “impelled by globalization’s challenges” manifest in e.g., countries’ voluntary adoption of “compatible or similarly directed domestic tax responses to common international economic events, which often are captured in a tailored way through bespoke tax treaties with legal force to align the specific intersection of countries tax regimes”,⁶ international tax disputes must rely heavily on the *inter alia* legal determinations of local courts, and negotiations of local tax authorities on the international stage.⁷

Rather than an ‘international tax system’, the international tax landscape is a patchwork of domestic tax regimes. Each country makes private laws which in turn feed the interpretations, meanings, and application of the tax law.⁸

Whenever private legal systems encounter one another in taxation or other circumstances, negotiations of state sovereignty are taking place. Law circumscribes and describes human life and behaviour. Local law should correlate to the way local people live and want to live.⁹ Tax law is no different.¹⁰ Tax law and policy are ultimately derived from social priorities which differ from nation to nation.¹¹ Social priorities drive political priorities.¹² Political priorities drive

⁵ Wilkie and Hogg, “Tax Law Within the Larger Legal System”, *supra* note 1 at 478.

⁶ Wilkie and Hogg, “Tax Law Within the Larger Legal System”, *ibid* at 478.

⁷ The OECD’s Pillars imply the creation of a single world order tax system via countries enacting domestic changes to their laws. For more detail on the Pillars, see discussion under the heading “3.4.1 OECD Picking Up Borderless World Paradigm” and Organisation for Economic Co-Operation and Development, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Paris: OECD, 2020) [OECD 2020 Pillars Report].

⁸ Because tax law is an accessory to the private law: Wilkie and Hogg, “Tax Law Within the Larger Legal System”, *supra* note 1 at 484; See also Matias Milet and Christopher Sheridan, “The Income Tax Act as ‘Accessory’: A Modern Re-Examination” in Jinyan Li, J Scott Wilkie, and Larry F Chapman, eds, *Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act* (Toronto: Canadian Tax Foundation, 2017) 13:1-31 [Milet and Sheridan, “The Income Tax Act as ‘Accessory’”].

⁹ Edward D Kleinbard, *We Are Better Than This: How Government Should Spend Our Money* (Oxford UK: Oxford University Press, 2014) [Kleinbard, *We Are Better Than This*].

¹⁰ Kleinbard, *We Are Better Than This*, *ibid*.

¹¹ Kleinbard, *We Are Better Than This*, *ibid*.

¹² Kleinbard, *We Are Better Than This*, *ibid*.

economic priorities.¹³ Economic priorities drive fiscal priorities.¹⁴ Encounter of local legal systems on the international stage means a negotiation of the bounds of local sovereignty.¹⁵

When two countries' private law characterize and render taxable the same item of income or capital at their respective domestic law, more than one country stakes a tax claim to it, causing tax claims to overlap and tax law and legal systems to come into encounter. Countries' tax systems increasingly encounter one another in a globalized, digitized, world economy dominated by multinational enterprises carrying on business in multiple jurisdictions at once. Corporate income is connected to more than one jurisdiction in a way that justifies more than one jurisdiction staking a legitimate tax claim to it on source or residence bases.

With each jurisdiction having the power to pass whatever tax laws it sees fit within its territory, double taxation of multinational enterprises is a real possibility. The international tax community is in consensus that excessive or double taxation would result in a slowdown of cross border flows. Domestic income tax laws are a two-pronged mechanism for raising revenue to support public spending, and incentivizing or disincentivizing behaviour.¹⁶ Tax treaties provide "some measure of organization about how these rules coexist internationally without impairing business activity and the mobility of capital and persons".¹⁷ This project and purpose emanates from the work of the League of Nations in the early 20th century.¹⁸ "[F]riendship, commerce, and navigation" treaties acknowledged countries' "legitimate claim to a shared tax base associated with international commerce" and that "a reliable means of sharing [was] critical".¹⁹ Early treaties endeavoured to "avoid gratuitous impediments to trade attributable to the regulation of business activities" on the understanding that countries had an individual and

¹³ Kleinbard, *We Are Better Than This*, *ibid*.

¹⁴ Kleinbard, *We Are Better Than This*, *ibid*.

¹⁵ See e.g., Dani Roderick, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: Norton, 2011) [Roderick, *Globalization Paradox*]: Democracies have the right to protect their social arrangements, and when this right clashes with the requirement of the global economy, it is the latter that should give way.... a thin layer of international rules that leave substantial room for manoeuvre by national is a better globalization. It can address globalization's ills while preserving its substantial economic benefits period we need smart globalization, not maximum globalization.... The real challenge is to safeguard the integrity of each nation's corporate tax regime in a world where enterprises and their capital are footloose. This challenge remains [in 2021] unaddressed.

¹⁶ See Scott Wilkie and Lara Friedlander, "Policy Forum: The History of Tax Treaty Provisions – And Why It Is Important To Know About", (2006) 54:4 Canadian Tax Journal 907 at 909 [Wilkie and Friedlander, "The History of Tax Treaty Provisions"].

¹⁷ See Wilkie and Friedlander, "The History of Tax Treaty Provisions", *ibid* at 909.

¹⁸ See Wilkie and Friedlander, "The History of Tax Treaty Provisions", *ibid* at 909.

¹⁹ See Wilkie and Friedlander, "The History of Tax Treaty Provisions", *ibid* at 909.

collective interest in “avoiding impediments to trading relationships in commercial activity occasioned by uncoordinated multiple taxation of the same income and the same taxpayers”.²⁰

In 1923, the League of Nations adopted the “benefits principle” whereby active income is taxed primarily in the country of source and passive income is taxed primarily in the country of residence.²¹ In 1927, the League of Nations papered the “single tax principle” to deal with “questions of tax evasion and double taxation in coordination with each other”, amounting to among “[t]he most elementary and undisputed principles of fiscal justice ... whereby all incomes would be taxed once and only once”.²²

In order to mitigate distortions arising from excessive taxation as identified by the League of Nations, international trade and domestic foreign policy goals, countries enter into tax treaties which to this day embody the “benefits principle” and “single tax principle”, to negotiate how each other’s residents will be treated in their treaty partner’s territory and in so doing allocate taxing rights between jurisdictions. The OECD Model Tax Treaty²³ and the United Nations (“UN”) Model Tax Treaty²⁴ on which most of the world's tax treaties are based and which themselves are substantially similar,²⁵ contain provisions for allocating taxing rights in respect of different income categories, e.g., interest, dividends, royalties, employment income, business income, capital gains, etc., on source or residence bases.

The international tax order is held together by these treaties to manage the overlap of countries’ tax claims. Bilateral tax treaties reflect political negotiations to allocate countries’

²⁰ See Wilkie and Friedlander, “The History of Tax Treaty Provisions”, *ibid* at 909.

²¹ Reuven Avi-Yonah, “International Taxation of Electronic Commerce”, (1997) 52 Tax L Rev 507 at 556 [Avi-Yonah, “International Taxation of Electronic Commerce”]; One of the economists on whose work the ideas were based was Edwin RA Seligman, “Double Taxation and International Fiscal Cooperation being a series of Lectures delivered at the Academie de Droit International de la Haye” (New York: McMillan, 1928).

²² Report Presented by the Committee of Technical Experts on Double Taxation and Tax Evasion, League of Nations Doc. G.216.M.85 II (1927) [League of Nations, Single Tax Principle Report].

²³ Organisation for Economic Co-Operation and Development, *Model Tax Convention on Income and on Capital: Full Version 2017* (Paris: OECD, 2017) [OECD 2017 Model Tax Treaty].

²⁴ United Nations, Department of Economic and Social Affairs, *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017* (New York: United Nations, 2017) [UN Model Tax Treaty].

²⁵ The OECD 2017 Model Tax Treaty, *supra* note 23, favours states imposing residence-based taxation, which are usually more economically developed countries. The UN Model Tax Treaty, *ibid*, favours states imposing source-based taxation, which are usually less economically developed countries.

respective taxing rights and to broker inter-nation deals using tax revenues as consideration.²⁶

Charles Kingson writes of the transactional nature of tax treaties:²⁷

To protect their international tax interests, countries negotiate tax treaties; and in the same way that [United States Tax Code] provisions identify the competing interests of taxpayers, treaty provisions identify those of countries. Source countries accede to the revenue needs of residence countries by limiting or foregoing tax; in return, residence countries enhance the ability of source countries to attract investment by either exempting income taxed in the source country or by crediting source country taxes against their own; and each recognizes the other's right to compete by agreeing not to discriminate in favor of its own nationals.

Ultimately, a tax treaty operates as contract between nations: mutual offers accepted with signatures, through the use of forgone tax revenues as consideration to meet the contracting states' shared and individual goals. The *Vienna Convention on the Law of Treaties* (“*VCLT*”) requires countries perform their treaties in “good faith”.²⁸ Tax treaties bear a striking likeness contracts both in the features necessary for their existence, i.e., offer, acceptance and consideration, and in their structure of defining terms,²⁹ setting the bargain,³⁰ elucidating what is required for its performance,³¹ and making corollary promises to enable the same.³² In this, tax treaties as contracts rely on a governing law.

All contracts, including tax treaties, need a governing law through which to ascertain the legal context, meaning of terms, and obligations. Conflicts of tax laws arise when the contracting states cannot ascertain the governing law for their treaty, resulting in simultaneous, legitimate, and divergent legal characterizations of an event or transaction in each contracting state. At the core of conflicts of tax laws is the question, ‘what is the nature of the transaction, person,

²⁶ In effect, countries face the “trilemma” Dani Roderick describes in his *Globalization Paradox* when negotiating their tax treaties (among other contexts), where countries must essentially choose between sovereignty, global trade, and democracy: Roderick, *Globalization Paradox*, *supra* note 15 at xv-xxii and 187-206; See also Stanley Surrey’s discussion of tax treaties as tax expenditures: Stanley S Surrey and Paul R McDaniel, “The Tax Expenditure Concept: Current Developments and Emerging Issues” (1979) 20:2 Boston College L Rev 225 at 336-354 on “International Aspects of Tax Expenditures” and specifically “Double Taxation Treaty Principles and Negotiations” at 348.

²⁷ Charles I Kingson, “The Coherence of International Taxation” (1981) 81:6 Colum L Rev 1151 [Kingson, “Coherence of International Taxation”] at 1157.

²⁸ As required by the *Vienna Convention on the Law of Treaties*, 1155 UNTS 331 (entered into force January 27 1980) [*VCLT*], art 26.

²⁹ E.g., Articles 2-5 of the OECD 2017 Model Tax Treaty, *supra* note 23, prescribe definitions for terms that appear in the distributive or bargain-containing articles.

³⁰ E.g., Articles 6-22 of the OECD 2017 Model Tax Treaty, *ibid*, set out how the contracting states agree to behave in respect of taxation of income and capital.

³¹ E.g., Articles 23A and 23B of the OECD 2017 Model Tax Treaty, *ibid*, provide rules for foreign tax recognition.

³² E.g., Articles 24-32 of the OECD 2017 Model Tax Treaty, *ibid*, address issues of non-discrimination, exchange of information, assistance in the collection of taxes, territorial extensions, coming into force, termination, among others

income, etc.?’ and the two (or more) divergent responses proffered to answer it. This legal question is important because from its answer can be determinations significant to the levying of tax. To come to the same answer of what the transaction is, countries need to know and agree on the governing law for their treaty, i.e., the mechanism through which the question of ‘what is the nature of the transaction, person, income, etc.?’ is answered. When the governing law is not identified or agreed upon, two or more legal systems conceivably apply to characterize a person, income, or event.³³ When those legal systems yield different characterizations, excessive or insufficient taxation may result. When governing law is identified and agreed upon, the question, ‘what is the nature of the transaction, person, income, etc.?’ is answered with the same legal responses by both countries who ask it, causing divergence and resultant undesirable tax outcomes to disappear.

There are multiple ways to ascertain the governing law of a tax treaty, among them, recourse to: unilateral domestic law, supranational law, and bilateral reconciliation. The unilateral domestic law approach involves countries passing domestic tax laws that tell the tax authorities, courts, and parties of states how income with an international character is characterized and taxed. For example, Canada’s *Income Tax Conventions Interpretation Act*,³⁴ is a statute of general interpretive application and applies to all Canada’s tax treaties. Section 3 identifies the governing law for certain treaty provisions as Canada’s law, and section 4 identifies the governing law for other circumstances.³⁵

The supranational approach includes international proposals that multinational corporate taxation should take place at the *de facto* global rather than national level through global tax laws effected through domestic tax laws, with proceeds allocated to countries on certain criteria instead of on the basis of source or residence entitlement. In the OECD’s Inclusive Framework on Base Erosion and Profit Shifting (“OECD IF on BEPS”), Pillar One, market jurisdictions in certain industries will tax residual profits via destination-based cash flow taxes, or formulary apportionment, instead of the current source/residence paradigm.³⁶

³³ For a similar concept, see Jacques Sasseville, “Klaus Vogel Lecture: Tax Treaties and the Schrödinger’s Cat” (2009) 63:2 Bulletin for International Taxation 45 [Sasseville, “Schrödinger’s Cat”].

³⁴ *Income Tax Conventions Interpretation Act*, RSC 1985, c I-4, s 2 [ITCIA].

³⁵ E.g., *ITCIA*, *ibid*, for permanent establishments in Canada (s 4); application of GAAR (s 4.1); stock exchanges (s 4.2); non-resident trusts (s 4.3); and further elucidated definitions (s 5).

³⁶ OECD 2020 Pillars Report, *supra* note 7.

The bilateral reconciliation approach appears in tax treaties and involves prioritizing one legal system over another depending on the circumstances while leaving the other contender unchanged. Tax treaties implicitly acknowledge reconciliation approaches through their latent incorporation of COL/col principles. Conflict of laws is a legal discipline and a system of thought³⁷ through which to reconcile simultaneously-applicable and legitimately-applicable legal systems. As will be discussed later, tax treaties employ a latent COL/col approach to ascertain governing law based on which of the contending countries has the closest legitimate connection to the events in question.

Unilateral, supranational, and reconciliatory approaches all endeavour to ascertain the governing law for the given treaty article. Unilateral approaches ascertain governing law by national initiatives without requirement of consultation with the other countries which such laws may affect. Supranational approaches propose to ascertain governing law by actual harmonization of contending legal systems through domestic law change.³⁸ Reconciliatory approaches seek a governing law by acknowledging and weighing the claims for one country's law to apply over the other, and by choosing one legal system out of the contenders with the closest legitimate connection to the events in question to carry the day. In these three approaches, the question of 'what is the nature of the transaction, person, income, etc.?' is answered, but each does so differently and with its cost.

If adopted as proposed, the cost of the supranational approach is adverse effects on state sovereignty. If there is only one *de facto* global tax law as the supranational approach proposes, there is no conflict of tax laws because the question of 'what is the nature of the transaction, person, income, etc.?' is answered by all countries in the same way. However, it is because countries' tax laws have conformed to a global standard rather than reflecting the specific local

³⁷ See Paul Schiff Berman, "The evolution of global legal pluralism" in Roger Cotterrell & Maksymilian Del Mar, eds., *Authority in Transnational Legal Theory: Theorising Across Disciplines* (Northampton, MA: Edward Elgar Pub, 2016) 151 [Schiff Berman, "Legal Pluralism"] regarding conflict of laws as a system of thought, i.e., as a "technique" and a "discursive framework that structures thought", citing Karen Knop, Ralf Michaels and Annelise Riles, "From Multiculturalism to Technique: Feminism, Culture, and the Conflict of Laws Style" (2012) 64 *Stan L Rev* 589. In a similar vein, see Dirk Pulkowski, *The Law and Politics of International Regime Conflict* (Oxford, Oxford University Press, 2014); Jeffrey L Dunoff, "A New Approach to Regime Interaction" in Margaret A Young, ed, *Regime Interaction in International Law: Facing Fragmentation* (Cambridge, Cambridge University Press, 2012) 136. For the different theories of conflict of laws, see Ralf Michaels, "Post-critical Private International Law: From Politics to Technique" in Horatia Muir Watt and Diego P. Fernández-Arroyo, eds, *Private International Law and Global Governance* (Oxford: Oxford University Press, 2014) 54.

³⁸ E.g., OECD 2020 Pillars Report, *supra* note 7.

intricacies of the countries and persons who live in them. The OECD IF on BEPS, Pillar Two, anticipates a global minimum tax by closing the door to low-tax incentives in countries that employ them. Pillar Two focuses on what amounts to a global minimum corporate tax with the effect of undermining local uses of tax expenditures.

Supranational approaches, and the costs they demand are unnecessary because tax treaties employing COL/col principles already have mechanisms to ascertain governing law via bilateral reconciliation. This approach to ascertaining governing law is most consistent with the historical purpose of tax treaties. As is seen from the League of Nations work discussed above, the purpose of tax treaties is to facilitate bilateral reconciliation and support states' sovereignty, not to harmonize sovereign state tax systems.

Approaches that reconcile multiple states' sovereignty are important because, according to Raz, a nation's law claims a position of comprehensive supremacy and authority and "[s]ince all legal systems claim to be supreme with respect to their subject-community, none can acknowledge any claim to supremacy over the same community which may be made by another legal system".³⁹ Absent a system for reconciliation, no sovereign state need cede to another. Legal pluralists such as Roughan advocate for an "account of law that explains how different supremacy claims can be integrated and mutually recognized while upholding the authority of law".⁴⁰ A state must "recognize the relativity of its own claim to the claim of others, and of their claims to its own"⁴¹ in order to "cooperate, coordinate, or tolerate one another if they are to have legitimacy".⁴² Tax treaties employ COL/col principles in order to do this.

The systematic way to negotiate state sovereignty where private legal regimes as the manifestation of state sovereignty encounter one another is the legal discipline of conflict of laws.⁴³ The purpose of conflict of laws as a legal discipline is to mediate states' sovereignty over their domains by adjudicating the extent to which that state's law as microcosmic encapsulations of social, economic, political and fiscal priorities, should apply in a dispute. Reconciliation of

³⁹ Joseph Raz, *The Authority of Law*, 2nd ed (Oxford, Oxford University Press, 2011) 117 [Raz, *Authority of Law*] at 119.

⁴⁰ Nicole Roughan, *Authorities: Conflicts, Cooperation and Transnational Legal Theory* (Oxford: Oxford University Press, 2013) [Roughan, *Authorities*] at 157.

⁴¹ Roughan, *Authorities*, *ibid* at 157.

⁴² Roughan, *Authorities*, *ibid* at 8.

⁴³ See e.g., Horatia Muir-Watt, "Theorizing transnational authority: A private international law perspective" in Roger Cotterrell & Maksymilian Del Mar, eds., *Authority in Transnational Legal Theory: Theorising Across Disciplines* (Northampton, MA: Edward Elgar Pub, 2016) 325 [Muir-Watt, "Theorizing Transnational Authority"]; Schiff Berman, "Legal Pluralism", *supra* note 37.

contending and legitimate claims by disparate legal systems lies at the heart of the conflict of laws project.

When compared to the supranational law projects such as the OECD's Pillars' implicit effort to harmonize legal systems through countries' benevolence and altruistic agreement, rather than reconciliation of domestic legal regimes through critical legal analysis, the principled and long-standing approach and utility of the conflict of laws discipline as a heuristic is more normatively sound.

Unlike the supranational approaches, the reconciliatory approach manifest in tax treaties employing COL/col principles acknowledges and supports the sovereignty of both contending legal systems, imploring their reconciliation rather than demanding their harmonization. In tax treaties' latent observance of COL/col principles, tax treaties acknowledge the inevitable encounter of countries' legal systems on the terrain of international taxation, anticipate diverse legal regimes, and support countries' law-making sovereignty by permitting both legal systems to remain intact, unchanged, and unharmonized even though one of the contending legal systems prevails over the other contenders and applies in the circumstances. In this, tax treaties already do what the supranational approaches intend to do by ascertaining a governing law, and do so without costs to state sovereignty.

The following chapters demonstrate how tax treaties implicitly observe COL/col principles to ascertain the governing law. Chapter 2 details the problems that can arise when treaties do not provide means to ascertain governing law using the example of hybrid mismatch. Chapter 3 explains the context and conceptual coherence of how tax treaties come to employ COL/col to ascertain governing law. Chapter 4 sets out the specific COL/col principles latently employed in the treaty provisions. Chapter 5 illustrates how COL/col principles are implicitly observed in tax treaty distributive rules. Chapter 6 illustrates how COL/col principles are latent in tax treaty anti-treaty shopping rules. This thesis concludes by emphasizing that to the extent that supranational harmonization approaches endeavour to ascertain the governing law for tax treaties, they are unnecessary because tax treaties already employ COL/col principles to do so through reconciliation and thus without the costs to state sovereignty imposed by harmonization.

2 Problem of No Governing Law in Tax Treaties

1.1. Problems When Governing Law Cannot Be Ascertained: Hybrid Mismatch

Ascertaining governing law and answering the question of ‘what is the nature of the transaction, person, income, etc.?’ is essential for tax treaties to operate.⁴⁴ “Hybrid mismatch” is an example of how things go awry when contracting states cannot identify and agree on governing law. The international tax community has struggled to ascertain governing law and answer the question of ‘what is the nature of the transaction, person, income, etc.?’ regarding “hybrid mismatch”.

Hybrid mismatch is often conceived of as ‘aggressive’ tax planning, but it is deeper than this. It is a governing law problem.

2.1.1 Meaning of ‘Hybrid Mismatch’

For the OECD, “hybrid mismatch” refers to arrangements implicating entities or instruments “used in aggressive tax planning to exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long-term taxation deferral”.⁴⁵ Fundamentally, hybridity is the result of multiple legal perceptions of the same instrument, entity, event, or transaction spurring multiple tax outcomes in and as a result of a multi-jurisdictional and multi-juridical world defined by its legal heterogeneity. Hybrids may result in outcomes including deduction/non-inclusion, double deduction, and indirect deduction/non-inclusion and can take the form of entities or instruments.⁴⁶

2.1.2 Hybrid Instruments

Convertible bonds are an example of a hybrid instrument “mismatch” of debt and equity features that may give rise to a deduction/non-inclusion outcome. Consider two related companies:

⁴⁴ Issues associated with ascertaining the applicable law arise in different case studies, e.g., taxation of digital businesses; hybrid transactions involving entities and instruments varying degrees of transparency and opacity depending on the borders involved; deductibility; transfer pricing; and the impact of choice of law clauses on treaty shopping and the extent to which the choice of law clause is valid.

⁴⁵ Organisation for Economic Cooperation and Development, “Action 2: Neutralising the effects of hybrid mismatch arrangements” (2019) Web: <https://www.oecd.org/tax/beps/beps-actions/action2/> [OECD, “Action 2”].

⁴⁶ See Organisation for Economic Co-Operation and Development, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report* (Paris: OECD, 2015) [OECD 2015 Hybrid Report].

Company A based in France, and its related Company B based in Australia.⁴⁷ French Company A makes a payment to Australian Company B pursuant to a convertible bond. Convertible bondholders receive fixed-income interest payments like creditors, but have the option to convert the bond into shares at which time they would be equity-holders. As a result of its bond- or debt-like qualities, and its security- or equity-like qualities, payments made pursuant to a convertible bond may be treated like deductible interest expenses in the jurisdiction of the payor, and tax-free dividends in the jurisdiction of the recipient. Under French domestic law, French Company A's payment is treated as interest and deductible for tax purposes. Under Australian law, the payment is treated as a dividend and benefits from a tax exemption. The result is a deduction in France without corresponding taxation in Australia. The convertible bond is a hybrid instrument that allows the payment to be deducted from French taxable income, and not included in Australian taxable income. Because France and Australia each apply their local law as the governing law, each answer the question of 'what is the nature of the transaction, person, income, etc.?' differently, resultantly characterize the instrument and payments thereto differently, and subsequently treat the payments differently in the tax law. The convertible bond gains its hybrid character because divergent laws simultaneously apply to characterize it, leading it to be seen differently depending on which side of a state border the beholder is located on.

2.1.3 Hybrid Entities

Regarding hybrid entities, USA LLCs and partnerships are examples of hybrid entity mismatches and 'reverse' hybrid entity mismatches respectively. USA LLCs are hybrid entities seen as fiscally transparent for USA tax purposes and fiscally opaque for foreign tax purposes, i.e., being treated as corporations in foreign jurisdictions.⁴⁸ USA partnerships are considered reverse hybrid entities such that they are fiscally opaque and a separate taxpayer for USA tax purposes, but are

⁴⁷ The scaffolding for the Australia/France example included in this discussion comes from the OECD's short video at Organisation for Economic Cooperation and Development, "Action 2: Neutralising the effects of hybrid mismatch arrangements", Video: "Fighting tax evasion: How to end hybrid mismatch arrangements" (2019) Web: <https://www.oecd.org/tax/beps/beps-actions/action2/> [OECD, "Action 2" video].

⁴⁸ Similarly, but in the reverse, Nova Scotian, British Columbian, and Albertan corporate law regime provides for the creation of "unlimited liability companies" or "ULCs" which are treated as corporations for Canadian tax purposes and partnerships for USA tax purposes. In Alberta, see *Business Corporations Act*, RSA. 2000, c B-9, s 15.2; In Prince Edward Island, see *Business Corporations Act*, RSPEI 1988, c B-6.01; In British Columbia, *Business Corporations Act*, SBC 2002, c 57, s 51.3; In Nova Scotia, see *Companies Act*, RSNS 1989, c 81, s 135.

fiscally transparent in foreign jurisdictions depending on its ‘check-box’ election⁴⁹ pursuant to regulations to be treated as corporation for USA tax purposes. The effect is taxation in the jurisdiction where the entity is opaque, and non-taxation in jurisdiction where the entity is transparent. The opaque entity may transfer much of what would otherwise be its income to its related transparent entity. If the opaque entity has no taxable income in the jurisdiction by virtue of transfers to a transparent entity in another jurisdiction, there will be no tax levied in the jurisdiction of opacity because there is no income, and no tax levied in the jurisdiction of transparency because the income is in the hands of an entity not recognized as a taxable person. Because the USA and its counterpart each apply their local law as the governing law, each answer the question of ‘what is the nature of the transaction, person, income, etc.?’ differently, resultantly characterize the entity and income thereto differently, and subsequently treat the income differently in the tax law. USA LLCs and partnerships gain their hybrid character because divergent laws simultaneously apply to characterize them, leading them to be seen differently depending on which side of a state border the beholder is located on.

2.1.4 Problem of Hybrid Instrument and Entity Mismatch

The problematized tax consequences that arise because of hybrid entity and instrument mismatch occur because of countries’ inability to determine what the governing law for determining the character of the transaction is considering their two different perceptions. Concurrent perceptions and applicable legal regimes lead to different treatment of the same event. At the core of the hybrid instrument and entity mismatch is an inability of contracting states to settle on one governing law, and subsequently, one perception of what the transaction is. If they could settle on one governing law, they could settle on one perception, with congruent tax treatment across borders being more likely.

Leaving aside hybridity’s negative connotations and understanding it in essential terms, ‘hybrid mismatch’ is a microcosm for the international tax environment and the dynamics at play within it. In the hybrid context, when the conflict of tax laws which gives rise to hybridity materialize, the first question should be, ‘how does each country legally see the transaction, and if different, whose legal perception should carry the day?’. This question is of particular

⁴⁹ Via IRS Form 8831, *Entity Classification Election*.

importance because tax treaties, including Articles 1, 23A, and 23B of the 2017 OECD Model Tax Treaty do not respond to hybrid instruments.

2.1.5 Governing Law Indicated for Hybrid Entity Mismatch

In the OECD 2017 Model Tax Treaty, the purpose of Article 1(2) is to address partnerships and other entities or arrangements that create whole or partial fiscal transparency. The OECD revised Article 1(2) in the OECD 2017 Model Tax Treaty to reflect this purpose pursuant to investigation on neutralizing the effects of hybrid entity mismatch.⁵⁰ The OECD Committee on Fiscal Affairs report, *The Application of the OECD Model Tax Convention to Partnerships* (“OECD 1999 Partnerships Report”)⁵¹ the Committee expressed particular concern with “cases where domestic tax laws create intermediary situations where the partnership is partly treated as a taxable unit and partly disregarded for tax purposes”.⁵² The OECD commentary to Article 1(2) is explicit that Article 1(2) responds to the OECD 1999 Partnership Report and “confirms the conclusions of the report in such a case”, i.e., being non-taxation of income where neither contracting states finds the income to belong to one of its residents.⁵³ In this, Article 1(2) implicitly acknowledges hybrid mismatch comes from the simultaneous application of two heterogenous legal regimes each applying a legal characterization about what it means to be a resident, with gaps in between. In acknowledging the problem arises from the encounter of different legal regimes, Article 1(2) latently acknowledges a governing law problem.

Article 1(2) concerns how income should be taxed in circumstances of fiscal transparency by indicating governing law as the law of the place where the person behind the fiscally transparent entity is located. Article 1(2) provides that:

[I]ncome derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.⁵⁴

⁵⁰ Per OECD 2017 Model Tax Treaty, *supra* note 23, M-7, para 2 was added to the 21 November 2017 version following the OECD 2015 Hybrid Report, *supra* note 46.

⁵¹ Organisation for Economic Co-Operation and Development, Committee on Fiscal Affairs, *The Application of the OECD Model Tax Convention to Partnerships* (Paris: OECD, 1999) [OECD 1999 Partnership Report].

⁵² OECD 1999 Partnership Report, *ibid* at 37.

⁵³ Commentary to Article 1(2) of the OECD 2017 Model Tax Treaty, *supra* note 23, C(1)-2).

⁵⁴ OECD 2017 Model Tax Treaty, *ibid*, art 1(2) (emphasis added). The UN Model Tax Treaty, *supra* note 24, art 1(2) contains identical wording. For the effects of changes in the OECD 2017 Model Tax Treaty affecting partnerships, see: Brian Arnold in Cooperation with the IBFD’s Tax Treaty Unit, “Hybrid Entities and the OECD Model (2017): The End of the Road?”, IBFD Bulletin for International Taxation (July 2018) 417.

Article 1(2) responds to hybrid entity mismatch by effectively looking through the hybrid entity and attributing income earned through it to the resident behind the fiscally transparent entity or arrangement. In Example 3, the OECD 1999 Partnership Report discussed instances where neither contracting state finds the income generated to belong to one of its residents, leaving all or part of it untaxed in either contracting state.⁵⁵ “Confirm[ing] the conclusions of the [OECD 1999 Partnership] report,” the commentary to Article 1(2) sets a method for taxing the income. It directs that “the reference to “income derived by or through an entity or arrangement” has a broad meaning and covers any income that is earned by or through an entity or arrangement, regardless of the view taken by each Contracting State as to who derives the income for domestic tax purposes and regardless of whether or not that entity or arrangement has a legal personality or constitutes a person as defined in [Article 3(1)(a)]”.⁵⁶ Included in this broad definition is, for example, “income of any partnership or trust that one or both of the Contracting States treats as wholly or partly fiscally transparent”, and even fiscally transparent entities established in a third state.⁵⁷ The term “income” also has a broad meaning.⁵⁸ Employing broad definitions of both entities or arrangements and the income they earn, the effect of Article 1(2) is that income of fiscally-transparent entities is attributed to the resident of one of the contracting states,⁵⁹ effectively looking through the fiscally transparent entity to the resident of the contracting state that sits behind it. The effect of Article 1(2) enables operation of other distributive rules in the OECD 2017 Model Tax Treaty.⁶⁰

The OECD 2017 Model Tax Treaty’s proposed treatment of hybrid entities including but not limited to partnerships in Article 1(2) is an example of how the OECD acknowledges instances of tax system encounter as a governing law problem and proposes resolution of the problem by locating governing law in the legal system with the closest connections. By effectively looking through the fiscally transparent entity and attributing broadly-defined “income” to the resident sitting behind the fiscally transparent entity or arrangement,⁶¹ the OECD 2017 Model Tax Treaty drives toward the legal system where the entity, arrangement, or

⁵⁵ OECD 1999 Partnership Report, *supra* note 51 at Example 3.

⁵⁶ Commentary to Article 1(2) of the OECD 2017 Model Tax Treaty, *supra* note 23, C(1)-(4).

⁵⁷ Commentary to Article 1(2) of the OECD 2017 Model Tax Treaty, *ibid.*

⁵⁸ Commentary to Article 1(2) of the OECD 2017 Model Tax Treaty, *ibid.*, C(1)-(4).

⁵⁹ For illustration, see Example 2 in OECD 1999 Partnership Report, *supra* note 51.

⁶⁰ Commentary to Article 1(2) of the OECD 2017 Model Tax Treaty, *supra* note 23, C(1)-(6)

⁶¹ Commentary to Article 1(2) of the OECD 2017 Model Tax Treaty, *ibid.*, C(1)-(6)

income has its closest actual ties, i.e., where the person behind the fiscally-transparent entity or arrangement, pulling its strings, resides.

Canada and the USA approached hybrid entities in essentially the same way in Articles 4(6) and (7) of the Canada-USA Tax Treaty following the Fifth Protocol in 2007.⁶² The *TD Securities (USA) LLC v Canada*⁶³ (“*TD Securities*”) case is illustrative of why the shift to this approach occurred. TD Securities (USA) LLC (“TD LLC”) was a Delaware LLC, based in and doing business in the USA with Canadian branch operations. The Canada Revenue Agency (“CRA”) treated TD LLC as a corporation and it paid Canadian branch tax at the 25% domestic rate, rather than the Canada-USA Tax Treaty rate of 5%. The USA tax authorities treated TD LLC as a transparent entity and as a result its income was included in the income of USA corporation TD Holdings II, its sole member. In turn, the income of TD Holdings II was included in the consolidated return of its sole shareholder, TD USA.

The issue before the court was whether TD LLC should pay Canadian branch tax at the domestic 25% rate or the treaty 5% rate. In answering this question, the court needed to determine if TD LLC was a USA resident, as the treaty rate only applies to persons resident in the USA.⁶⁴

The Tax Court rejected the CRA’s position that LLCs including TD LLC were not residents of the USA for the purposes of the treaty because the LLCs were treated as flow-throughs for USA tax purposes, and therefore not entitled to treaty benefits including the 5% rate. The Tax Court held that the LLCs including TD LLC were residents for the purposes of the Canada-USA Tax Treaty for the pre-Fifth Protocol periods. In coming to its conclusion, the Tax

⁶² *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital*, Canada and United States, 26 September 1980 as amended by the Protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007 [Canada-USA Tax Treaty]; *Protocol Amending the Convention Between Canada and the United State of America With Respect to Taxes on Income and on Capital: Annex B* (Fifth Protocol, 21 September 2007) [Fifth Protocol].

⁶³ *TD Securities (USA) LLC v Canada*, 2010 TCC 186 [*TD Securities*]; See discussion in Jinyan Li, Arthur Cockfield, and J Scott Wilkie, *International Taxation in Canada: Principles and Practices*, 4th ed (Toronto: LexisNexis, 2018) [Li, Cockfield and Wilkie, *International Taxation*] at 73-75.

⁶⁴ Cases from other jurisdictions include: *Swift v HMRC*, [2010] UKFT 88 (TC) where in the court weighed the characteristics of partnerships and corporations on which the availability of the foreign tax credit turned (entities characterized as partnerships had the opportunity to claim the foreign tax credit for members, whereas entities characterized as corporations did not) when tasked with determining the application of the United kingdom's foreign tax credit; *Bayfine UK Products Bayfine UK v Revenue & Customs*, [2008] UKSPC SPC00719, where counterparties in derivative transactions or recognize this corporations under the UK tax law but not the USA tax law and the significance of this difference for the purpose of the applicable treaty.

Court adopted a contextual and purposive reading of the terms “resident” and “liable to tax”.⁶⁵ The court derived the context and purpose of the treaty provisions by ascertaining the treatment of other entities, including USA S corporations, partnerships, government entities, trusts, charities, and pension funds, for the purposes of “residence” in the Canada-USA Tax Treaty. The court also consulted the OECD 1999 Partnership Report and relevant commentary.⁶⁶

The court held that TD LLC was entitled to treaty benefits because it is subject to comprehensive taxation in that the USA “comprehensively taxes the worldwide income of TD LLC as fully as if it had been earned by any other entity including a USA domestic corporation”,⁶⁷ by virtue of TD LLC’s income being included in the income of TD Holdings II, whose income was subsequently included in TD USA's consolidated tax return.

Articles 4(6) and 4(7) of the Canada-USA Tax Treaty are a practical interpolation of the OECD 1999 Partnership Report and deviation from the result in *TD Securities*. These articles were introduced by the Fifth Protocol, taking effect January 1, 2010.⁶⁸ The Canada-USA Tax Treaty Articles 4(6) and 4(7) reads:

6. An amount of income, profit or gain shall be considered to be derived by a person who is a resident of a Contracting State where:

- (a) the person is considered under the taxation law of that State to have derived the amount through an entity (other than an entity that is a resident of the other Contracting State); and
- (b) by reason of the entity being treated as fiscally transparent under the laws of the first-mentioned State, the treatment of the amount under the taxation law of that State is the same as its treatment would be if that amount had been derived directly by that person.

7. An amount of income, profit or gain shall be considered not to be paid to or derived by a person who is a resident of a Contracting State where:

- (a) the person is considered under the taxation law of the other Contracting State to have derived the amount through an entity that is not a resident of the first-mentioned State, but by reason of the entity not being treated as fiscally transparent under the laws of that State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that amount had been derived directly by that person; or
- (b) the person is considered under the taxation law of the other Contracting State to have received the amount from an entity that is a resident of that other State, but by reason of the entity being treated as fiscally transparent under the laws of the first-mentioned State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that entity were not treated as fiscally transparent under the laws of that State.

⁶⁵ Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 74.

⁶⁶ *TD Securities*, *supra* note 63 at para 101.

⁶⁷ *TD Securities*, *ibid* at para 96.

⁶⁸ Fifth Protocol, *supra* note 62.

The articles represent the countries' respect for legal systems, but acknowledge their tax treaty objectives, and use selection of a governing law via Articles 4(6) and 4(7) to deliver those objectives.

The Canada-USA treaty is arguably Canada's most important given the proximity of the two nations and the extent to which the two economies rely on each other, particularly considering Canada's status as a small, open economy. The two countries have similar tax⁶⁹ and private legal systems, and engage in substantial trade with each other.⁷⁰ In this context with much on the line, the contracting states have explicitly considered that both of their laws may apply and come into conflict, and opted that one of them shall take priority as the governing law to neutralize the effect of hybrid entity mismatch.

Article 1(2) of the OECD 2017 Model Tax Treaty and Articles 4(6) and (7) of the Canada-USA Tax Treaty indicates governing law in respect of hybrid entities, but does not deal with hybrid instruments.

2.1.6 No Governing Law Indicated for Hybrid Instrument Mismatch

Usually, in questions of which countries' law should apply for the purposes of the other country granting exemption or credit to the other, Articles 23A and 23B⁷¹ of the OECD 2017 Model Tax Treaty step in. In the instance of hybrid instrument mismatch, it does not do so. Generally, there are two kinds of conflicts that can arise as contracting states seek the allocative outcomes of their tax treaties: "qualification" conflicts, and "classification" conflicts.⁷²

2.1.6.1 Qualification Conflicts

Qualification conflicts result where both countries agree their tax treaty applies to the event from which income was generated, but because of differences in the treaty countries' domestic laws,

⁶⁹ While Canada and the United States have similar recognitions between the tax and legal systems, a substantial difference between the Canadian and USA tax system is that the USA allows selective/elective/choice of legal constructions through an elective regime via IRS Form 8831, *Entity Classification Election*.

⁷⁰ Canada's exports to the United States are worth \$336,215 million and a partner share of 75.37% in 2019. Canada's imports from the United States are worth \$229,986 million and a partner share of 50.73% in 2019. See Office of the United States Trade Representative, "Canada" web: <https://ustr.gov/countries-regions/americas/canada>; World Integrated Trade Solution, "Canada exports, imports, tariff by year", web: <https://wits.worldbank.org/CountryProfile/en/Country/CAN/Year/LTST/Summarytext>.

⁷¹ OECD 2017 Model Tax Treaty, *supra* note 23, arts 23A and 23B.

⁷² See the commentary to Article 23A and 23B at OECD 2017 Model Tax Treaty, *ibid* at C(23)-1 through C(23)(37).

each believe that a different provision or income category of their treaty applies. For example, based on the contracting states' differing domestic law regarding employment versus independent contractor, one contracting state may qualify the income as income from employment, whereas the other might qualify it as income from business.

For qualification conflicts, notwithstanding the different articles of the treaty the contracting states purport to be taxing the amounts in accordance with, the OECD 2017 Model Tax Treaty provides an answer for how they should resolve their disagreement and decide whose determination of the treaty provision applicable carries the day. The rules to resolve qualification conflicts appear in the specific income articles themselves, or in Article 23A or 23B. Article 23A and 23B offer internal and self-executing resolution mechanisms prescribing if the residence country or source country should provide an exemption or credit where amounts are “being taxed in accordance with the Convention”.⁷³ In circumstances of qualification conflict, the income is technically being taxed in accordance with the convention in both countries even if the countries cannot agree on which of the two articles apply. This is because no matter which of the contending articles turns out to apply, either article is correct at the contracting states' respective domestic laws and lawful under their treaty. Income is still being “taxed in accordance with the Convention” even if countries consider different articles of the convention to apply. As such, taxation will be in accordance with the convention in any event of the qualification conflict. The commentary to the OECD 2017 Model Tax Treaty provides:⁷⁴

32.1 Both Articles 23 A and 23 B require that relief be granted, through the exemption or credit method, as the case may be, where an item of income or capital may be taxed by the State of source in accordance with the provisions of the Convention. Thus, the State of residence has the obligation to apply the exemption or credit method in relation to an item of income or capital where the Convention authorises taxation of that item by the State of source.

...

32.3 Different situations need to be considered in that respect. Where, due to differences in the domestic law between the State of source and the State of residence, the former applies, with respect to a particular item of income or capital, provisions of the Convention that are different from those that the State of residence would have applied to the same item of income or capital, the income is still being taxed in accordance with the provisions of the Convention, as interpreted and applied by the State of source. In such a case, therefore, the two Articles require that relief from double taxation be granted by the State of residence notwithstanding the conflict of qualification resulting from these differences in domestic law.

⁷³ Commentary to Article 23A and 23B at OECD 2017 Model Tax Treaty, *supra* note 23 at C(23)(15) - C(23)(17) at paras 32.3 and 32.5.

⁷⁴ Commentary to Article 23A and 23B at OECD 2017 Model Tax Treaty, *ibid* at C(23)(15)-C(23)(16) at paras 32.1 and 32.3 with an example at para 32.4.

In effect, contending claims of contracting states are resolved through black-letter rules prescribing the governing law and thus whose qualification applies and what the other state should do given that finding.

2.1.6.2 Classification Conflicts

Classification conflicts or “conflicts of interpretation”,⁷⁵ including hybrids are not provided black-letter rules to ascertain the governing law. These kinds of conflicts result from “different interpretation of facts or different interpretation of the provisions of the Convention”.⁷⁶ The commentary reads:⁷⁷

32.2 The interpretation of the phrase “may be taxed in the other Contracting State in accordance with the provisions of this Convention”, which is used in both Articles, is particularly important when dealing with cases where the State of residence and the State of source classify the same item of income or capital differently for purposes of the provisions of the Convention.

...

32.5 Article 23 A and Article 23 B, however, do not require that the State of residence eliminate double taxation in all cases where the State of source has imposed its tax by applying to an item of income a provision of the Convention that is different from that which the State of residence considers to be applicable. For instance, in the example above, if, for purposes of applying paragraph 2 of Article 13, State E considers that the partnership carried on business through a fixed place of business but State R considers that paragraph 5 applies because the partnership did not have a fixed place of business in State E, there is actually a dispute as to whether State E has taxed the income in accordance with the provisions of the Convention. The same may be said if State E, when applying paragraph 2 of Article 13, interprets the phrase “forming part of the business property” so as to include certain assets which would not fall within the meaning of that phrase according to the interpretation given to it by State R. Such conflicts resulting from different interpretation of facts or different interpretation of the provisions of the Convention must be distinguished from the conflicts of qualification described in the above paragraph where the divergence is based not on different interpretations of the provisions of the Convention but on different provisions of domestic law. In the former case, State R can argue that State E has not imposed its tax in accordance with the provisions of the Convention if it has applied its tax based on what State R considers to be a wrong interpretation of the facts or a wrong interpretation of the Convention. States should use the provisions of Article 25 (Mutual Agreement Procedure), and in particular paragraph 3 thereof, in order to resolve this type of conflict in cases that would otherwise result in unrelieved double taxation.

As the commentary describes, when classification conflicts arise, from the perspective of each contracting state, the income is not being taxed in accordance with the convention by the other state because each contracting state believes the other contracting state has wrongly ascertained

⁷⁵ To take the term used by Jacques Sasseville in Sasseville, “Schrödinger’s Cat”, *supra* note 33 at 46. Wilkie engaged Sasseville’s “Schrödinger’s Cat” as a metaphor for the source of income question in Scott Wilkie, “New Rules of Engagement? Corporate Personality and the Allocation of “International Income” and Taxing Rights” in Brian Arnold, ed, *Tax Treaties After the BEPS Project: A Tribute to Jacques Sasseville* (Toronto: Canadian Tax Foundation, 2018) 349 [Wilkie, “Corporate Personality and Allocation].

⁷⁶ Commentary to Article 23A and 23B at OECD 2017 Model Tax Treaty, *supra* note 23 at C(23)(15) - C(23)(17) at paras. 32.3 and 32.5.

⁷⁷ Commentary to Article 23A and 23B at OECD 2017 Model Tax Treaty, *ibid* at C(23)(15)-C(23)(16) at paras 32.2 and 32.5.

the facts or wrongly interpreted the treaty. At that moment, two legal systems apply with discordant results before their mutual exclusivity is realized. Jacques Sasseville describes these conflicts as akin to Schrödinger's cat, where in the face of two quantum mechanical events, neither yet materialized, a cat could be simultaneously alive and dead at the same time.⁷⁸

If contracting states did not include internal treaty rules in their bargain to direct whose law should apply as the governing law to answer the question of 'what is the nature of the transaction, person, income, etc.?', how should the applicable law be ascertained? Which of the contracting states has the authority to decide the facts of the transaction, driving the conclusion on the proper interpretation and application of the treaty terms?

For classification conflicts, Article 23A and 23B provide only a process for resolution. Where amounts are not "being taxed in accordance with the Convention," Article 23A and 23B point to Article 25 which offers the resolution process of the Mutual Agreement Procedure.⁷⁹ If countries do not accept the Panel's decision, the two legal systems continue to apply with discordant results, their mutual exclusivity necessary for the treaty to function never realized. As Jacques Sasseville notes, "if quantum mechanics resulted in a cat being both alive and dead at the same time, this would be a rather counter-intuitive result".⁸⁰ The convention does not provide a mechanism, framework, or principled approach to be employed for the resolution of classification conflicts in Mutual Agreement Procedure negotiations. Contending claims of contracting states are resolved through negotiations by tax authorities, i.e., Competent Authorities.⁸¹ Mutual Agreement Procedure proceeds on the assumption that both countries have legitimate legal grounds for asserting the application of respective domestic laws. Neither country is required to defer or concede to the claim of the other, as in Raz's conception.⁸² Absent

⁷⁸ Sasseville, "Schrödinger's Cat", *supra* note 33 at 48. See also Rebecca Kysar, "Interpreting Tax Treaties" (2016) 101:4 Iowa L Rev 1387, especially, "IV.E.1. Domestic Law", at 1413, describing the case of *Boulez v Commissioner*, 83 TC 584 (1984) (USA) where the issue was if payments for musical performances in the USA were royalties taxable in Germany, or compensation for personal services taxable in the USA. Germany and the USA applied divergent characterizations of the payments. Art 3(2) of the USA-Germany tax treaty could not resolve the conflict because each country asserted its claim on the basis of source and residence respectively. The USA applied its domestic rules to find the income was payment for personal services and taxable in the USA.

⁷⁹ Commentary to Article 23A and 23B at OECD 2017 Model Tax Treaty, *supra* note 23 at C(23)(15) - C(23)(17) at paras 32.4 and 32.5.

⁸⁰ Sasseville, "Schrödinger's Cat", *supra* note 33 at 48.

⁸¹ See discussions from scholars at the Michigan Journal of International Law Digital Symposium as summarized in Lukas Kutilek, "The Multilateral Instrument: A New Array of Questions" (2017) 38 MJIL Digital Symposium 1 at 10.

⁸² Raz, *Authority of Law*, *supra* note 39.

compulsion, compromise is required. Competent authorities negotiate their countries' respective deviations from applying its own law, however legitimately, and instead devise bespoke governing law to apply to the circumstances.⁸³

Absent the circumstantial creation of bespoke law, it is unclear which of the contending contracting states' law should apply as the governing law to answer the question of 'what is the nature of the transaction, person, income, etc.?' in a classification conflict. There is no natural, universal law of relationships, entities, instruments, transactions, or persons to look to for an answer to this question,⁸⁴ so harmonization or reconciliation is necessary.

2.1.7 International Responses to Hybrid Instrument Mismatch

Considering the problematized tax consequences of e.g., transparency and opacity⁸⁵ resulting in hybrid instrument versus entity mismatch scenarios flowing from the encounter, interaction, and potential conflict of countries' tax laws and therefore legal systems, and the fact that the treaty does not provide an answer, international guidance has emerged.

The OECD has spearheaded extensive research on hybrid mismatch to neutralize the effects of heterogeneous legal and factual perceptions of events. The OECD considers hybrid mismatch a significant issue because of its role in tax base erosion in concerned jurisdictions and how its widespread prevalence magnifies such effects.⁸⁶ An early acknowledgement by the OECD of the risks and effects of hybrid mismatch appeared in its 2010 report, *Addressing Tax Risks Involving Bank Losses* ("OECD 2010 Bank Losses Report")⁸⁷ concerning the international

⁸³ See Scott Wilkie, "Article 25: Mutual Agreement Procedure – Global Tax Treaty Commentaries" in Richard Vann et al (eds) *Global Tax Treaty Commentaries IBFD* (Amsterdam: IBFD, 2014) noting the effects and permissions of Article 25(1) and particularly (3) the latter essentially being a "make law" provision which would include organizational and transactional perceptions to suit the overall objective of a treaty. Deviations include stretching what local law would otherwise allow or require. Professor Wilkie writes that tax treaties apply so the laws of each state are operate in a principled, legitimate way, so treaties always involve an element of law making to arrive at the prevailing legal and tax system in the circumstances, see e.g., art 25(3) of the OECD 2017 Model Tax Treaty, *supra* note 23.

⁸⁴ Just as there is no natural law of source: Ault and Bradford, "Taxing International Income", *supra* note 1 at 31; Wilkie and Hogg, "Tax Law Within the Larger Legal System", *supra* note 1 at 478

⁸⁵ Regarding transparency and opacity, see beneficial ownership, see e.g., Organisation for Economic Co-Operation and Development, *Double Taxation and the Use of Conduit Companies* (Paris: OECD, 2019) [OECD 2019 Conduit Report]; and "treaty shopping" as discussed in "5.1.2.1.1. 'Beneficial Ownership' Cases".

⁸⁶ OECD, "Action 2", *supra* note 45.

⁸⁷ Organisation for Economic Co-Operation and Development, *Addressing Tax Risks Involving Bank Losses* (Paris: OECD, 2010) [OECD 2010 Bank Losses Report].

banking context,⁸⁸ noting revenue authorities should “bring to the attention of their government tax policy officials those situations which may potentially raise policy issues, and, in particular, those where the same tax loss is relieved in more than one country as a result of differences in tax treatment between jurisdictions, in order to determine whether steps should be taken to eliminate that arbitrage/mismatch opportunity”.⁸⁹ The OECD revisited the issue in its 2011 report, *Corporate Loss Utilisation through Aggressive Tax Planning* (“OECD 2011 Corporate Loss Report”)⁹⁰ wherein it recommended countries “consider introducing restrictions on the multiple use of the same loss to the extent they are concerned with these results”.⁹¹

Various OECD countries conducted their own reviews and identified instance tax planning through hybrids.⁹² The OECD subsequently released its 2012 report, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (“OECD 2012 Hybrid Report”)⁹³ identifying the effect of hybrid arrangements on tax revenues, their negative effect on efficiency, transparency and fairness in tax systems, and their adverse effect on competition.⁹⁴ While the report could not identify which countries’ tax bases were eroded as a result of hybrid mismatch, the report concluded that hybrid mismatch indeed put the collective tax base at risk. Among the various policy options advanced to address hybrid mismatch scenarios, the report concluded that “domestic law rules which link the tax treatment of an entity, instrument or transfer to the tax treatment in another country had significant potential as a tool to address hybrid mismatch arrangements”.⁹⁵

The OECD’s most recent dedicated study of the topic is the OECD’s Action 15 Report, *Neutralizing the Effects of Hybrid Mismatch Action 2: 2015 Final Report*, released in 2015 (“OECD 2015 Hybrid Report”).⁹⁶ The OECD’s 2015 Hybrid Report builds on the OECD’s 2012 Hybrid Report by setting out the domestic law linking rules touted as promising in the OECD’s 2012 Hybrid Report. The OECD 2015 Hybrid Report advocates neutralizing hybrid mismatch

⁸⁸ OECD, “Action 2”, *supra* note 45; OECD 2010 Bank Losses Report, *supra* note 87.

⁸⁹ OECD 2010 Bank Losses Report, *ibid*.

⁹⁰ Organisation for Economic Co-Operation and Development, *Corporate Loss Utilisation through Aggressive Tax Planning* (Paris: OECD, 2011) [OECD 2011 Corporate Loss Report].

⁹¹ OECD 2011 Corporate Loss Report, *ibid*.

⁹² OECD, “Action 2”, *supra* note 45.

⁹³ Organisation for Economic Co-Operation and Development, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (Paris: OECD, 2012) [OECD 2012 Hybrid Report].

⁹⁴ OECD 2012 Hybrid Report, *ibid*.

⁹⁵ OECD 2012 Hybrid Report, *ibid*.

⁹⁶ OECD 2015 Hybrid Report, *supra* note 46.

through countries enacting these linking rules via changes to their domestic tax laws.⁹⁷ The linking rules include domestic hybrid financial instrument rules,⁹⁸ disregarded hybrid payments rules,⁹⁹ reverse hybrid rules,¹⁰⁰ deductible hybrid payments rules,¹⁰¹ dual-resident payer rules,¹⁰² and imported mismatch rules.¹⁰³ The rules are organized into a hierarchy based on tie-breakers to ensure jurisdictions do not apply different rules concurrently and create confusion. “The report recommends that every jurisdiction introduce all the recommended rules so that the effects of hybrid mismatch arrangements are neutralized even if one of the other jurisdictions does not have effective hybrid mismatch rules”.¹⁰⁴

The planned combined effect of the rules is to align tax outcomes across jurisdictions. The OECD’s 2015 Hybrid Report advocates that countries can achieve the effects of common legal or factual perception of events, transactions, and instruments, and eliminate deduction/non-inclusion, double deduction, and indirect deduction/non-inclusion, even if they do not truly share the same actual legal or factual perception or characterization of events in their domestic laws. The report does not target harmonization of corporate, commercial, or regulatory law outcomes, discordance of which across jurisdictions gives rise to hybridity.¹⁰⁵ Rather, the report focuses on aligning the tax treatment of hybrid scenarios. This is accomplished by effectively harmonizing tax systems so deductions are allowed or disallowed on similar grounds across different countries. Chapters 2 and 5 of the OECD 2015 Hybrid Report advocates the following harmonization:¹⁰⁶ denial of dividend exemptions and equivalent relief from economic double tax regarding deductible payments made pursuant to financial instruments; introduction of measures to prevent the use of hybrid transfers to duplicate credits for withholding taxes at source; alteration of the effect of controlled foreign corporations and other offshore investment regimes so that hybrid entities’ income comes under the charge to tax of the investor jurisdiction; adoption by countries of information reporting and filing requirements concerning tax transparent entities established in the reporting country’s jurisdiction; restriction on the tax

⁹⁷ OECD 2015 Hybrid Report, *ibid* at Part 1 “Recommendations for domestic law”.

⁹⁸ OECD 2015 Hybrid Report, *ibid*, ch 1.

⁹⁹ OECD 2015 Hybrid Report, *ibid*, ch 3.

¹⁰⁰ OECD 2015 Hybrid Report, *ibid*, ch 4.

¹⁰¹ OECD 2015 Hybrid Report, *ibid*, ch 6.

¹⁰² OECD 2015 Hybrid Report, *ibid*, ch 7.

¹⁰³ OECD 2015 Hybrid Report, *ibid*, ch 8.

¹⁰⁴ OECD 2015 Hybrid Report, *ibid*, at 19.

¹⁰⁵ OECD 2015 Hybrid Report, *ibid* 46, at 16.

¹⁰⁶ OECD 2015 Hybrid Report, *ibid*, at 16.

transparency of reverse hybrids that are members of a control group; and implementation of hybrid mismatch rules that adjust tax outcomes in one jurisdiction to accord with the tax outcomes in another jurisdiction in the event of a hybrid mismatch arrangement in order to reduce deduction/non-inclusion, double deduction, or indirect deduction non-inclusion outcomes.

After the release of the OECD's final Action 2 recommendations in the OECD 2015 Hybrid Report, some countries involved in the Inclusive Framework adopted comprehensive rules to address the effects of a wide range of hybrid mismatch and branch mismatch, echoing those rules in the OECD's 2015 Hybrid Report.¹⁰⁷ The United Kingdom ("UK"), Australia, and New Zealand passed legislation reflecting the common approach prescribed by Action 2.¹⁰⁸ The USA, occupying a sometimes-antagonistic role among OECD countries, issued regulations to the *Tax Cuts and Jobs Act*¹⁰⁹ to clarify the application of hybrid mismatch rules.¹¹⁰

The EU's *Anti-Tax Avoidance Directive II*¹¹¹ bears much similarity to the OECD's 2015 Hybrid Report. *ATAD II* expands and provides rules for hybrid permanent establishment mismatch, hybrid transfers, hybrid financial mismatches, dual resident mismatches, reverse hybrid entity mismatch, and imported mismatches. *ATAD II* applies where there is corporate tax liability, a structured mismatch arrangement, and effective control in a hybrid context. It targets deduction/non-inclusion and double deduction outcomes. *ATAD II* operates through a "primary rule" and a "secondary rule". Under the primary rule, the mismatch is neutralized by the state of the payer denying the deduction. If the primary rule is not applied, the secondary rule allows the state of the receiver to add the amount of the payment to the receiver's taxable income.¹¹² The member states of the EU adopted *ATAD II* and countries must have brought the hybrid mismatch rules into effect by early-2020.

The OECD's 2015 Hybrid Report and *ATAD II* take the (correct, as will be discussed later) position that differences between local regimes is the cause of different, or "mismatching" characterizations, giving rise to the hybrid mismatch problem. In response, the OECD's 2015 Hybrid Report and *ATAD II* articulate a domestic tax law harmonization effort targeted at

¹⁰⁷ Other countries have rules that deal with hybrid effects. See OECD 2012 Hybrid Report, *supra* note 9, ch 4, detailing countries that have specific hybrid mismatch rules; and the OECD 2015 Hybrid Report, *ibid*.

¹⁰⁸ OECD, "Action 2" video, *supra* note 47.

¹⁰⁹ *Tax Cuts and Jobs Act*, Pub L No 115-97 (2017).

¹¹⁰ OECD, "Action 2" video, *supra* note 47.

¹¹¹ *Anti-Tax Avoidance Directive II*, Council Directive (EU) 2017/952 of 29 May 2017 amending *Anti-Tax Avoidance Directive I*, Council Directive (EU) 2016/1164 [*ATAD II*].

¹¹² Analogous to the "defensive rule/action" in the OECD 2015 Hybrid Report, *supra* note 46.

creating uniform tax treatment of a transaction, event, or instrument. The approach in both instances of international direction is to neutralize the effects of different, or “mismatching” characterizations by neutralizing the effects of differences in local regimes from which they result through homogenous tax laws across borders, i.e., enacting common understandings about how and when to allow or disallow deductions or take defensive action in the face of states’ passivity on hybrid issues. This is plain in both instances of international guidance emphasizing countries change their domestic laws to accord with a coordinated effort toward legal system homogeneity.

The OECD is explicit that the solution to the lack of coordination in the two countries’ laws is domestic law changes.¹¹³ For example, in the double deduction context, the BEPS project calls for countries to deny the tax exemption for payments that are deductible in another jurisdiction, and if this does not happen, the country wherein the deduction would otherwise be enjoyed will neutralize the mismatch by denying the deduction claimed by the payer.¹¹⁴ *ATAD II* is similarly explicit.

The 2015 OECD Hybrid Report and *ATAD II* stress the importance of having a consistent answer to the question, ‘what is the nature of the transaction, person, income, etc.?’ and an effort to determine governing law by all involved countries having the same law. While the 2015 OECD Hybrid Report and *ATAD II* do not seek countries legislate uniform perceptions of, for example, debt and equity, or partnerships and corporations, they do seek entities or instruments with the hallmarks of hybridity to receive uniform tax treatment across a network of nations. Both the 2015 OECD Hybrid Report and *ATAD II* acknowledge that until the contracting states arrive at a common response to hybridity, the tax outcomes, gaps, and consequences resulting from countries’ different characterizations of transactions and amounts paid pursuant to them will persist.

Both instances of international guidance view domestic tax law as by, of, and unto itself and thus propose domestic tax law harmonization to relieve hybrid mismatch. Hybrid mismatch, like all instances of international tax encounter, is first and foremost a legal problem. A hybrid instrument mismatch arises from two simultaneous and concurrent legal characterizations of a payment made pursuant to an instrument existing simultaneously and therefore attracting

¹¹³ OECD, “Action 2” video, *supra* note 47.

¹¹⁴ OECD, “Action 2” video, *ibid.*

different and “mismatching” tax treatment. The OECD 2015 Hybrid Report and *ATAD II* acknowledge that differences between local regimes is the cause of different, or ‘mismatching’ characterizations, giving rise to the hybrid mismatch problem. While true, is tax system harmonization, contingent on countries’ political negotiation¹¹⁵, benevolence and even altruism,¹¹⁶ the answer? Is tax system harmonization the only answer, and given the implications of systemic harmonization and the presence of viable and predictable alternatives, the necessary answer?¹¹⁷

¹¹⁵ I.e., transnational, self-interested concessions, per Kingson, “Coherence of International Taxation”, *supra* note 27.

¹¹⁶ I.e., of sorts, particularly where there are foreign aid connotations and re-distributive goals. See e.g., Joanne Meyerowitz, “The G-7 discussed a new global tax. But we could be even more ambitious” (June 15, 2021) Washington Post [Meyerowitz, “Redistributive Global Tax”].

¹¹⁷ See also Horatia Muir-Watt, “Conflict of Laws Unbounded: The Case for a Legal-Pluralist Revival” (2016) 7:3 *Transnational Leg Theory* 313; Florian Rodl, “Democratic Juridification without Statisation: Law of Conflict of Laws instead of a World State” (2011) 2:2 *Transnational Leg Theory* 193.

3 Context

3.1 Solving Legal Problems with Legal Tools

Legal problems should be solved with legal frameworks to glean legal determinations. On this point, Lord Andrew Burrows of the Supreme Court of the United Kingdom (as he is now) wrote:¹¹⁸

In re-invigorating private law research, it seems to me essential that the merits of rigorous doctrinal analytical research on case law and legislation should be re-emphasized. In other words, rather than seeing the cure to reviving private law as lying in a replacement of traditional doctrine by, for example, deep philosophical or sociological theory it is my view that practical legal scholarship including comparative law should be applauded not derided.

The OECD's reliance on political negotiation¹¹⁹ and states' altruism,¹²⁰ i.e., urging countries to initiate domestic tax law reform with normative aims, rather than employing a principled legal framework in the pursuit of governing law, despite it being an imminently "legal" problem is precisely what Lord Burrows cautioned against. Considering such cautionary calls, investigation into the legal problem and dynamics underlying conflicts of tax laws and the search for governing law in tax treaties is a fruitful path to approaching it in a more principled way.

3.2 Tax Law as Accessory to Domestic Private Law

Conflicts of tax law arise because countries concurrently apply their domestic laws giving rise to different legal characterizations of the same event, person, income, etc., and then subsequently treat the event, person, income, etc., differently for domestic tax law purposes, causing a clash. Tax law is accessory to private law.¹²¹ Wilkie and Hogg write of tax as an accessory to the domestic law, such that tax law looks to *inter alia* the private law characterizations of entities,

¹¹⁸ Andrew Burrows, "Challenges for Private Law in the 21st Century", a paper presented at the conference, *Private Law in the 21st Century* (Brisbane, December 14-15, 2015) [Burrows, "Challenges for Private Law"]. For more epigrammatic and honest perspectives, see Andrew Burrows, *Thinking About Statutes: Interpretation, Interaction, Improvement* (Cambridge, UK: Cambridge University Press, 2018) [Burrows, *Thinking About Statutes*].

¹¹⁹ I.e., transnational, self-interested concessions, per Kingson, "Coherence of International Taxation", *supra* note 27.

¹²⁰ I.e., of sorts, particularly where there are foreign aid connotations and re-distributive goals. See e.g., Meyerowitz, "Redistributive Global Tax", *supra* note 116.

¹²¹ Milet and Sheridan, "The Income Tax Act as 'Accessory'", *supra* note 8.

instruments, relationships, events, persons, etc., as at the very least a starting place to calibrate tax outcomes.¹²² Wilkie and Hogg write:

Tax law, the framework for imposing tax and achieving the objectives served by a tax system, generally requires a tax subject (the taxpayer), a tax object (an item of property, a service, or some other manifestation of value) that the tax law defines or that is defined by the underlying private law to which the tax law is accessory, and a tax “realization event” (commonly associated with a “disposition” or some other reckoning event by which the tax system brings to account the value of a tax object in relation to a tax subject).¹²³

The legal characterizations provided by domestic private law areas such as corporate law, property law, trust law, etc. are essential inputs to the tax law for arriving at determinations of tax outcomes. The corporate law serves up a characterization based on, for example, the applicable corporate statute and jurisprudence, and on that pretense, the tax law applies to effect a tax outcome.

On the domestic stage, the Canadian *ITA* illustrates how tax law is an accessory to domestic private law. By virtue of the constitutional division of powers, Canada’s provinces maintain legislative power over corporate regulation, resulting in distinct and sometimes different corporate statutes in each province. While bearing many similarities, they have important differences that can drive divergent tax outcomes when the federal *ITA* applies to provincially divergent characterizations. Examples include the different tax treatment of amalgamations depending on the different provincial statutes.¹²⁴

On the international stage,¹²⁵ the Canadian *ITA* also illustrates how tax is an accessory to the domestic law. Not only does the *ITA* rely on domestic private law characterizations to drive tax outcomes, but on foreign private law characterizations as well. The foreign tax credit rules in

¹²² Wilkie and Hogg, “Tax Law Within the Larger Legal System”, *supra* note 1. Tax systems do deviate from consistent treatment of private law creations would defeat tax policy goals, e.g., the foreign tax credit generator cases.

¹²³ Wilkie and Hogg, “Tax Law Within the Larger Legal System”, *ibid* at 484.

¹²⁴ See e.g., Anu Nijhawan and Gabrielle MR Richards, “Corporate Combinations: An Update on Canadian Mergers”, 8 (2016) *2013 Conference Report* (Toronto: Canadian Tax Foundation, 2014) 1; Wendi P Crowe and Tom L Senyk, “Amalgamation and Windup: What’s the Difference?” *2003 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2003);

¹²⁵ Other examples of how the tax outcome changes as a result of how the applicable private law characterizes the event on the “international” stage include: the differences between the Canadian provinces’ corporate law statutes driving different outcomes upon application of the *Income Tax Act*, RSC 1985, c 1 (5th Supp) [*ITA*]; foreign affiliate system, i.e., under the *ITA*’s foreign affiliate regime, treatment of dividends from foreign corporations depends on the status of the corporation as a foreign affiliate and the nature of the income. For the foreign affiliate regime in this context, see Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 269; see also Bill Holmes and Ian Gamble, *The Foreign Affiliate Rules* (Alphen aan den Rijn: Wolters Kluwer: 2020).

section 126¹²⁶ exemplify ambulatory adoption of foreign private law to drive a Canadian domestic tax outcome, the latter as accessory to the former even across state borders. Sections 126 and 91 essentially import the foreign private law characterization of an arrangement to determine if that arrangement attracted tax in the foreign jurisdiction, and allows or disallows the Canadian foreign tax credit on that basis.¹²⁷ As Li, Wilkie, and Cockfield write, “Canada has effectively absorbed foreign private and tax law determinations on an ambulatory basis to determine if there is foreign tax that should be recognized as an offset to Canadian tax”.¹²⁸

Double tax relief through e.g., the foreign tax credit is necessary because Canadian resident corporations and Canadian resident individuals are taxable on their worldwide income from a source.¹²⁹ If the corporation and the individual earn income from sources outside of Canada, double taxation may result. In the interest of tax equity and neutrality, the *ITA* relieves double taxation through the foreign tax credit,¹³⁰ deductions for foreign tax,¹³¹ and exemption of foreign income from Canadian tax.¹³²

¹²⁶ On the foreign tax credit, Robert Couzin, “The Foreign Tax Credit” in *1976 Tax Conference Report* (Toronto: Canadian Tax Foundation, 1976), 69-99; Ian Gamble, “Canada’s Foreign Tax Credit System for Multinationals” (1999), (1997) 19 *Tax Notes Int’l*; Ryan L Morris and Michael D Templeton, “Unsuccessful Attack on Foreign Tax Credit Generators” (2011) 59 *Can Tax J* 547; Ken Snider, “The Foreign Tax Credit Rules” in *2001 Conference Report* 14:1 (Toronto: Canadian Tax Foundation, 2001); Roberto P Vasconcellos and H David Rosenbloom, “Measuring a Foreign Tax Credit Generator Transaction Against the Codified Economic Substance Doctrine” (2010) *Tax Notes Int’l* 119.

¹²⁷ In its own way, the Canadian foreign tax credit is a domestic response to hybridity employing a choice of law approach discussed later. The Canadian foreign tax credit regime acknowledges the dynamics that two or more legal systems are applying to characterize the event and levy tax, resulting in double taxation, which can be resolved by only one legal system applying to characterize the event and levy tax. Other countries adopt the approach of ‘writing over’ or employing outcome-based responses to hybrids, e.g., the United States rules at US Code Title 16, IRC [USA *IRC*] § 267A. The Canadian approach of respecting legal characterizations and the United States approach of looking beneath the transaction for hybridity outcomes are consistent with the Canadian and United States’ status as “legal substance” and “economic substance” jurisdictions respectively.

¹²⁸ Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 75, directing to Chapter 11.

¹²⁹ *ITA*, *supra* note 125, ss 3 and 4.

¹³⁰ *ITA*, *ibid*, s 126.

¹³¹ *ITA*, *ibid*, ss 20(11) and (12). Deductions for foreign tax at subsections 20(11) and (12) provide the taxpayer may deduct foreign taxes when computing its income from business or property in certain circumstances. This effective rendering of foreign tax as deductible from income from business or property treats foreign tax as a deductible business expense as ordinarily provided under s 18: Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 266.

¹³² *ITA*, *supra* note 125, ss 122.3 and 113(1)(a). Exemption of foreign income from Canadian tax at ss 122.3 (regarding individuals working overseas; allowing overseas working individuals to claim a credit up to \$80,000 in respect of foreign source employment income in certain circumstances; future fruitful research could be done on whether there is an ambulatory adoption of foreign law element) and 113(1)(a) (allowing Canadian corporations to deduct the full amount of dividends received from a foreign affiliate out of the foreign affiliates “exempt surplus” account; future fruitful research could be done on whether there is an ambulatory adoption of foreign law element) involves Canada conceding its tax claim to the jurisdiction where the foreign income is earned. Notwithstanding s 3, which provides that worldwide income from all sources including foreign sources is included when computing

Among these three methods, the foreign tax credit is the main mechanism for relieving double taxation.¹³³ The foreign tax credit operates so that a Canadian taxpayer's Canadian income tax in respect of foreign source income is reduced by the amount of foreign income tax that person paid up to the amount of Canadian income tax owed.¹³⁴ A Canadian taxpayer's Canadian income taxes are reduced by the amount of income taxes paid by the Canadian taxpayer to foreign governments by allowing a credit against Canadian tax liability for foreign taxes paid. The *ITA*, sections 91 and 126, will not grant a credit unless, based on the foreign law's characterization, tax was actually levied and paid in the foreign jurisdiction. If there was no tax paid in the foreign jurisdiction, because under the foreign law, the entity, instrument, relationship, etc. as characterized did not attract tax, the *ITA* will not provide for a credit.¹³⁵

The foreign tax credit is available to Canadian resident taxpayers¹³⁶ and non-resident taxpayers who pay Part 1 tax on non-Canadian income from sources. The amount for which the credit is sought must have been paid to a foreign government pursuant to an "income or profits" tax. "Taxes" are "extracted under compulsion of law" and "collected as revenue to be used for general public or government purposes".¹³⁷ While the term "income" is undefined in the *ITA*, section 3 provides clues, i.e., income must have a source: office, business, employment, or property. In order to determine if a foreign tax is an "income or profits tax", the *ITA* implies comparison of the scheme of application of the foreign tax to the scheme of application of income and profits taxes imposed domestically under the *ITA*. If the basis of taxation for the foreign tax is substantially similar, i.e., levied on net income or profits, it is an income or profits tax.¹³⁸ Sections 126(2) and 126(1) apply subsequently and respectively to credit "business-

Canadian income for tax purposes, s 122.3 and 113(1)(a) directly or indirectly exempt foreign source income from Canadian taxation via inclusion-then-deduction or credits.

¹³³ Deductions for or exemptions of foreign tax operate alongside or, where the taxpayer does not elect to take the foreign tax credit or the foreign taxes are not eligible for the credit, in place of the credit.

¹³⁴ See discussion in Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 268-273.

¹³⁵ The foreign tax credit regime is reflective, whether deliberate or not, of COL/col principles discussed later, i.e., Canada legislatively determining, via the *ITA*, *supra* note 125, that the transaction has the most connections to the foreign jurisdiction, and the choice of law for issues concerning those entities or instruments are where those entities are established or instruments are created, performed, have their "proper law". By integrating a foreign legal determination from the jurisdiction of closest connection along choice of law lines, the *ITA* implicitly undertook a conflict of laws analysis. The Canadian foreign tax credit's ambulatorily adoption, *de facto* acceptance of foreign law as fact, and notional "recognizing and enforcing" the foreign law/legal characterization going forward when Canada grants a credit, under treaty or otherwise.

¹³⁶ *ITA*, *ibid*, s 126(1).

¹³⁷ Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 271.

¹³⁸ Canada Revenue Agency, Income Tax Folio, S5-F2-C1, "Foreign Tax Credit" at paras 1.5-1.15; Li, Cockfield and Wilkie, *International Taxation*, *ibid* at 272 regarding determination as an income or profits tax.

income tax” and “non-business-income tax”. “Business-income tax” is defined at section 126(7) as “the portion of any income or profits tax paid by the taxpayer for the year to the government of a country other than Canada that can reasonably be regarded as tax in respect of the income of the taxpayer from a business carried on by the taxpayer in the business country”.¹³⁹ “Non-business-income” tax is defined in negative terms as including a foreign income or profits tax that is not foreign business income tax and is not deductible under section 20(11) for the year, e.g., tax on employment income, capital gains, passive investment income (i.e., dividends, interest, royalties, and rent). The extent of the credit is limited by its “territorial source”, i.e., the amount of Canadian tax payable on income earned in a foreign jurisdiction.¹⁴⁰ Before the taxpayer receives the foreign tax credit, the foreign tax must be “paid... for the year”, as per section 126(1). Proof of payment is required.¹⁴¹

The foreign tax credit’s current form reflects a governmental response to ‘foreign tax credit generators’.¹⁴² Foreign tax credit generator cases describe instances where Canada provides a credit for foreign tax even though under the law of the foreign jurisdiction, foreign tax was not paid. Foreign tax credit generators emerge where the tax treatment in the two countries, i.e., the source country where the transaction takes place and the crediting country where the taxpayer resides and seeks the foreign tax credit, are different. In the source country, the classification of the arrangement as it happens in that source country does not attract tax treatment at all, or by the end of the transaction. In the crediting country of taxpayer residence however, the classification of the arrangement as it happened in the source country where the transaction takes place would attract tax under the laws of the residence country. Accepting that the arrangement happened in the source country, and concluding that the arrangement attracts tax under the crediting countries law, the crediting country uses the foreign tax credit mechanism to

¹³⁹ *ITA*, *supra* note 125, s 126(7). A fruitful future inquiry would investigate and discuss if “business or property” is as defined at foreign law, or as defined at Canadian law, because if as defined at foreign law, it would show a further ambulatory adoption of the foreign law.

¹⁴⁰ Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 274.

¹⁴¹ Li, Cockfield and Wilkie, *International Taxation*, *ibid* at 279.

¹⁴² See Webb J’s reasons in the Tax Court decision in *4145356 Canada Ltd v R*, 2011 TCC 220 [*RBC* case] regarding the application of the foreign tax credit in the context of partnerships. In those cases, Canada gave credit through the foreign tax credit mechanism for foreign tax that was never paid and never existed in the United States tax system. Canada’s foreign tax credit laws changed in response to foreign tax credit generators. The OECD 2015 Hybrid Report, *supra* note 46, was released in 2015. The changes in Canadian law came well before the OECD’s treatment of the issue. Canada’s foreign tax credit is an example of the very “linking rules” countries are encouraged to adopt in the OECD 2015 Hybrid Report.

credit tax in respect of an arrangement that, because it was never recognized as a taxable event in the source jurisdiction, never attracted tax in the first place.

The Tax Court of Canada’s decision in *4145356 Canada Ltd v R*¹⁴³ (“RBC case”) was an essential catalyst.¹⁴⁴ In the case, a subsidiary of the Royal Bank of Canada (“RBC”) acquired portions of a USA limited partnership based in Delaware for consideration of \$400 million CAD. Subsidiaries of the Bank of America also acquired a portion in the Delaware limited partnership for a total consideration of \$1.2 billion CAD.¹⁴⁵ The USA limited partnership issued a loan worth 1.6 billion CAD to a third Bank of America subsidiary. On this loan, the USA limited partnership earned approximately 38 million CAD in interest. The USA limited partnership elected to be treated as a corporation for USA tax purposes. As a result, it paid USA income taxes in the amount of \$13 million CAD for the tax year in question. The USA limited partnership then allocated \$9 million to the RBC subsidiary, related to the portion the RBC subsidiary had acquired initially, and subsequently deducted \$3 million as a foreign tax credit, representing the USA taxes the USA limited partnership paid. In the end, the RBC subsidiary achieved net income of \$6 million.

The CRA denied the RBC subsidiary’s claim for the foreign tax credit on the grounds that the RBC subsidiary did not pay any USA taxes for which it now sought credit. The Tax Court was tasked with determining whether the RBC subsidiary was entitled to claim the foreign tax credit in the amount of \$3 million for the USA income taxes it paid pursuant to subsection 126(2) of the *ITA* or Article 24(2) of the Canada-USA Tax Treaty.

The court allowed the foreign tax credit generator arrangement. Referring to section 96 and 126(2) of the *ITA*, Justice Webb interpreted the phrase “paid by the taxpayer” in subsection 126(2) broadly, such that the person paying versus liable for the taxes, i.e., the USA limited

¹⁴³ *RBC case, ibid.*

¹⁴⁴ *RBC case, ibid.*

¹⁴⁵ The exercise of deferring to the foreign jurisdiction’s legal characterization is similar to Canadian court’s deference legal substance of a transaction in a domestic setting, and deference when it comes to detecting economic substance beneath the legal form. See e.g., *Canadian Deposit Insurance Company v Canadian Commercial Bank*, [1992] 2 SCR 558; CJ Bowman’s reasons in the *Continental Bank Leasing v Canada*, [1995] 1 CTC 2135; See also *Canada Trustco Mortgage Co v Canada*, 2005 SCC 54 definitively denying judicial independence to make law; In the GAAR context, the GAAR is employed to interpret the bounds of law, rather than displace, subvert, or amend, etc. it. In *Cameco Corp v HMQ*, 2020 FCA 112 aff’g 2018 TCC 195 [*Cameco*], and *Canada v Alta Energy Luxembourg SARL*, 2020 FCA 43 aff’g 2018 TCC 152 [*Alta Energy TCC*] the issue is the compliance of the essence of the event, and Canadian courts interrogate the essence of the event within the parameters of the statute s 247 in *Cameco* context or the tax treaty in the case of *Alta Energy*.

partnership and the RBC subsidiary respectively, need not be the same legal person. Justice Webb noted that to deny the RBC subsidiary its claim to the foreign tax credit would result in double taxation.

Foreign tax generators “are just another example of how tax and supporting legal and accounting systems in fact are not homogeneous and do not necessarily mesh in the way that the “international tax rules” of any one jurisdiction might expect is or should be the case”.¹⁴⁶ Li, Wilkie, and Cockfield remark that “these sorts of transactions challenge the interpretation and effect of foreign tax credit rules, and invoke questions of whether they involve unacceptable tax avoidance according to a “general anti avoidance rule” or like anti-tax avoidance doctrine”.¹⁴⁷ Even though foreign tax credit generator cases showed that the opportunity existed for tax avoidance, the general anti-avoidance rule (“GAAR”) or similar anti-tax avoidance doctrine were not employed as a first resort. It became clear through the foreign tax credit generator cases that the opportunity for avoidance was the symptom of a different problem, as can be inferred from what the legislature did in response. The opportunity for avoidance was a symptom of multiple domestic legal regimes applying to effect different tax treatment across countries classifying the same event or transaction for tax purposes. If the problem is the mismatch of classification occurring because of concurrent application of divergent legal regimes and characterization, with the opportunity for avoidance as merely a by-product, the problem ought to be solved by addressing the mismatch instead of reverting to anti-avoidance rules.

Li, Wilkie, and Cockfield identify one of the complex tax avoidance questions flowing from the foreign tax credit provisions as demonstrated by the foreign tax generator cases as being: “which countries’ terms of reference or law should be applied to characterize the transaction or arrangement as insubstantial or artificial” and “whether one country -- crediting country -- is permitted to determine the terms on or consequences with which another country’s commercial and tax law apply for their own purposes”.¹⁴⁸ In this respect, the *RBC* case is essentially a private law conflicts decision from which the tax outcomes flow naturally. The Tax Court determined that the Canadian *ITA* directed the conflicting Canadian and USA legal characterizations be prioritized in a certain way and the conflict of tax laws resolved in a certain

¹⁴⁶ Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 289.

¹⁴⁷ Li, Cockfield and Wilkie, *International Taxation*, *ibid* at 289.

¹⁴⁸ Li, Cockfield and Wilkie, *International Taxation*, *ibid* at 289.

way. The tax results followed, and ultimately amounted to what the legislature deemed unacceptable tax avoidance.

Parliament amended the foreign tax credit regime with the effect of eliminating multiple mismatching characterizations by directing what the governing law for characterizing the income in foreign tax credit claims would be, reducing the symptomatic opportunities for avoidance through hybrids through legal rather than anti-avoidance means. The new legislation addressed the problem of mismatching characterizations, and the symptomatic tax avoidance was resolved subsequently. Now the foreign tax credit provisions at *ITA* sections, 126(4), 1.1, 1.2, 1.3, 91(4.1-4.6) provide for an implied ambulatory adoption of the foreign private law to determine if the characterization of the arrangement in the foreign legal system attracted tax for which Canada should give credit.¹⁴⁹ See subsections 126 (4.11) - (4.13) and supporting rules. Subsection 124(4.11) refers to the “relevant foreign tax law” (emphasis added).

(4.11) If a taxpayer is a member of a partnership, any income or profits tax paid to the government of a particular country other than Canada — in respect of the income of the partnership for a period during which the taxpayer’s direct or indirect share of the income of the partnership under the income tax laws (referred to in subsection (4.12) as the “relevant foreign tax law”) of any country other than Canada under the laws of which any income of the partnership is subject to income taxation, is less than the taxpayer’s direct or indirect share of the income for the purposes of this Act — is not included in computing the taxpayer’s business-income tax or non-business-income tax for any taxation year.

Subsection 124(4.11) shows how the foreign tax credit rules engage ambulatory adoption of private law to make tax determinations. Partnership income may be taxed at the partnership level in the USA. Partnerships are not taxable persons in Canada and partnership income is not taxed at the partnership level in Canada. In Canada, partners bear tax in their capacity as singular tax units, i.e., individuals, corporations, etc., proportionate to their ownership, share, etc. in the partnership. In respect of USA taxes paid by the partnership to be credited under the Canadian foreign tax credit, Canadian tax authorities look to see how the USA tax authorities have characterized the arrangement under USA corporate private law. Finding the USA has characterized the arrangement as a partnership under USA corporate private law and that characterization has attracted tax, Canada will accept the USA characterization of the arrangement as a partnership and the USA tax outcome associated with it. Accepting that the

¹⁴⁹ The foreign affiliate rules mirror these changes. See *ITA*, *supra* note 125, subsections 91(4.1)-(4.5), and *Income Tax Regulations*, CRC c 945 [ITR], 5907 (1.02)-(1.06), and 5907(2) which effectively ensures consistency with basic elements of the *ITA*, *supra* note 125.

characterization attracted a foreign tax, Canada will give credit for USA taxes paid up to the amount of Canadian taxes owing. The USA tax determination, and thus the underlying private legal system that gave rise to it, is ported into Canadian statutory interpretation context to determine the Canadian tax outcome.

The Department of Finance's technical notes describe these changes as to "address tax schemes established by taxpayers with the intent of creating foreign tax credits and similar deductions for foreign tax, the burden of which is not, in fact, borne by the taxpayer".¹⁵⁰ The legislative changes thus limit foreign tax credits where the taxpayer is considered to have a smaller interest in the foreign income under the foreign law compared to the interest in the foreign income it would have under the Canadian law for Canadian tax purposes.

The Canadian foreign tax credit is an example of tax systems operating as accessory to the domestic private law. The Canadian foreign tax credit mechanism relies on an ambulatory adoption of, in this case, another country's private law characterizations to come to domestic conclusions about how the Canadian tax law should apply. The application of the foreign tax credit is premised on whether Canada should concede its tax base in favor of another countries' tax base. In answering this question, the *ITA* impliedly asks if under the foreign tax law, taking all the elements important to foreign tax law including the surrounding foreign legal system in which the foreign tax law is embedded into consideration, what the characterization of the arrangement in the foreign jurisdiction is, and based on the characterization of the arrangement at foreign law, if there was a foreign tax. The effect of this conceptual posture is that in Canada, the availability of the foreign tax credit depends on if there has been a foreign tax. The foreign legal characterization and tax outcome is imported for Canadian income tax interpretation purposes, and the foreign tax credit is extended or denied on that basis.

Tax law is an accessory to the domestic private law and relies on private law characterizations but only to the extent that the private law characterizes an event in accordance with its fiscal significance of the private law in the context.¹⁵¹ Domestic private law drives tax outcomes to the extent that the fiscal significance of the private law characterization is congruent

¹⁵⁰ Department of Finance Technical Notes on foreign tax credit rules in *ITA*, *ibid*, ss 126(4.11)-(4.13) and foreign affiliate rules in ss 91(4.1)-(4.5), and *ITR*, *ibid* note 149, 5907(1.02)-(1.06), cited in Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 290.

¹⁵¹ Wilkie, "Corporate Personality and Allocation, *supra* note 75 regarding the fiscal significance of entities; J Scott Wilkie, "The Way We Were? The Way We Must Be? The 'Arm's Length Principle' Sees Itself (for What It Is) in the 'Digital' Mirror" (2019) 47:12 *Intertax* 1087.

across the taxation and private law contexts. Said another way, where the private law and the tax law have the same objective in the situation, the tax system will generally take the private law characterization and impose tax on its basis. If different, the tax law will adjust its outcome.

An example of such adjustment appears in the treatment of payments pursuant to qualified preferred shares treated as interest rather than dividends in instances of perceived loss transmission.¹⁵² The *ITA* treats dividends paid pursuant to ownership of certain qualified preferred shares as interest because the purchase of the qualified preferred shares behaves more like an extension of credit, with the payments pursuant thereto behaving more like interest, than as purchase of equity, with the payments pursuant thereto behaving more like dividends. The tax law accepts and acknowledges that the corporate law characterizes the payment as a dividend, but declines to extend it the treatment ordinarily afforded to dividends given the fiscal significance (or lack thereof) of the dividend in that situation. The dividend's fiscal significance (or lack thereof) does not accord with the *ITA*'s general anti-loss sale sentiment.¹⁵³ The tax law acknowledges and accepts the private law's characterization but opts to treat the characterization differently in order to achieve the tax goal. Even where the tax law deviates from treating all private law characterizations of the same kind in the same way, the example of preferred shares shows how domestic private law remains at the very least a useful point of first reference for the determination of tax outcomes in the Canadian *ITA*, but from which the *ITA* will deviate if policy priorities do not align.

The Canadian income tax system is full of examples of both domestic and foreign private law being folded into domestic tax legislation to drive a domestic tax outcome. Canada's consultation and integration of private law characterizations into the tax law illustrate tax law as an accessory to domestic law.

3.3 Conceptualizing Tax Treaty Disputes as a Conflict of Laws

Acknowledging that in the context of a digitized and globalized world economy, income is connected to more than one tax jurisdiction that legitimately levies tax, and considering tax law

¹⁵² See e.g., Joan E Jung, "The Taxable Preferred Share Rules and the Private Corporation", *2017 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2017).

¹⁵³ See e.g., anti-surplus stripping discussed in H Heward Stikeman and Robert Couzin, "Surplus Stripping" (1995) 43:5 Can Tax J 1844; Robert Raizenne, "Surplus Stripping" *Tax Planning Using Private Corporations: Analysis and Discussion with Finance* (Ottawa: Canadian Tax Foundation, 2017).

is an accessory to the domestic law, overlapping tax claims result in the encounter of domestic private legal systems. The fact of both countries applying tax necessarily means that the income is being characterized by two (possibly different) legal systems because tax outcomes are derived from private law characterization inputs.

Generally, domestic law is incorporated in the tax treaty context via treaty articles and interpretive exercises included with them to inform outcomes under the article in question. Considering there is no tax law without private law to act as its life-giving blood and structural bones, any reference to tax law in a treaty or otherwise carries with it the private legal system in which tax law is embedded, including most overtly characterizations of entities, instruments, transactions, and events characterized at private law as a necessary precursor to determining their tax status and treatment.

In globalized business transactions on small (e.g., your Amazon purchase) and large scales (e.g., Coca-Cola's intergroup contracts for IP and intangibles¹⁵⁴), the fact that tax is applied by both countries who the transaction touches mean that tax is bringing those legal systems together to encounter one another. The fact that two or more countries both wield a tax claim presents an occasion for the meeting of private legal systems on the terrain of that that single income-generating event.

In any event of the new occasions for encounter and possibly conflict ushered in by globalization and digitalization, the fact of the matter is that the same encounter of private legal systems is happening in the tax context as in any other context. Taxation is a way that private legal systems meet each other, similarly to how legal systems meet in other situations, such as in contracts, car accidents, marriage and divorce, etc., where the subjects or objects of legal rules straddle nation state boundaries. Because tax law is an accessory to the domestic private law, conflicting tax regimes signify an underlying conflict of domestic private legal regimes. COL/col illuminates and animates the dynamics underscoring conflicts of tax law as tax treaty governing law problems, which result from the concurrent application of two or more domestic legal systems. Conflicts of tax law and the challenge of ascertaining governing law associated with them arise because of lack of homogeneity across and between legal systems. The fact that tax

¹⁵⁴ See Reuven Avi-Yonah's discussion of the recent Coca Cola case, *Coca-Cola Co v Commissioner*, 155 TC No 10 (2020) in "Coca-Cola: A Decisive IRS Transfer Pricing Victory, At Last", *Tax Notes Federal*, December 14, 2020.

law is an intermediary to this conflict of laws must not be allowed to obscure its true nature. It is a conflict of private laws that is drawing tax regimes into conflict.

Kysar conceptualizes tax treaties as “jurisdictional overlays to the parties’ tax systems and substantially rely on upon domestic law”, submitting tax treaties contemplate the inclusion and ambulatory adoption of domestic law characterizations, as compared to other treaties,¹⁵⁵ which do not to the same degree as in tax treaties. At 1411 she posits that tax treaties as incomplete contemplate importation of domestic law, providing an enhanced role for domestic law in tax treaties, consistent with but distinct from treaty interpretation norms generally. In any event of the enhanced role of domestic law in tax treaties, Kysar acknowledges at 1402 that interpretive approaches to tax treaties should not contradict general principles of treaty interpretation at international law.

General principles of treaty interpretation at international law contained in the combined operation of Articles 26, 27, 31 and 32 of the *VCLT* illustrate that treaty interpretation endeavours to ascertain a single governing law out of more than one conceivable contender. All treaties, including tax treaties, must comply with the articles of the *VCLT*. One of the implications of the combined effect of Articles 26, 27, 31 and 32 of the *VCLT* is that countries must not thwart the application of an otherwise legitimate treaty because their domestic laws provide differently. Article 27 concerns “internal” law and observance of treaties, and provides that “[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty” effectively foreclosing multiplicities of disparate legal regimes from applying. Relatedly, Article 26 provides that “[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith”.¹⁵⁶ Articles 31 and 32 provide general and supplementary rules of treaty interpretation suggesting that countries are working toward one, not many, interpretations of the treaties’ terms. Articles 26, 27, 31, and 32 *VCLT* prohibits concurrent, disparate laws from applying to interpret the treaty, suggesting instead the pursuit of one governing legal system through bespoke definitions or otherwise.

For the treaty to effectively allocate taxing rights to income, only one characterization can carry the day. Recalling Jacques Sassville’s description of the metaphysics behind the

¹⁵⁵ Kysar, “Interpreting Tax Treaties”, *supra* note 78 at 1387, 1423, and “V.A.1. Interaction with International Law” at 1432.

¹⁵⁶ *VCLT*, *supra* note 28, art 26.

classification dispute as a Schrödinger's cat, two outcomes exist simultaneously before folding into reality where only one is true and can be true.¹⁵⁷ Sasseville's illustration bears much similarity to descriptions of the legal discipline, conflict of laws and its subset "choice of law". Before employing a COL/col analysis ascertain the governing law, both private laws of both jurisdictions conceivably apply to the dispute. COL/col is the way in which the box is opened to determine whether Schrödinger's cat is alive or dead. Approaching conflicts of tax law from a conflict of laws disciplinary mindset provides a means to glean the underlying dynamics to challenges associated with ascertaining the governing law.

Public and private international law thematically converge.¹⁵⁸ One such convergence is that both legal disciplines pursue a single, legitimately-chosen (if chosen) domestic governing law with the closest connections to the event in order to determine rights and obligations created through bargains between parties across nations without displacing or altering the law of any of the contenders. Michaels writes that in the face of legal fragmentation and conflicts between legal orders, the best response is recourse to "the discipline that was made for that precise purpose".¹⁵⁹ The conflict of laws discipline creates a platform for determination of what happened legally, allowing a governing law to be ascertained and to not be thwarted by the conflict.

3.4 Conflict of Laws Retaining Relevance in the 'Borderless' World

If conflict of laws describes the dynamics underscoring conflicts of tax law and the pursuit of governing law when they arise, why then has the OECD declined to look to the discipline for conceptual guidance when making its international recommendations? While the reasons cannot be known with certainty, and in any event of the reasons, the OECD's reliance on political negotiation¹⁶⁰ and possibly, states' altruism,¹⁶¹ i.e., urging countries to initiate domestic tax law

¹⁵⁷ Sasseville, "Schrödinger's Cat", *supra* note 33.

¹⁵⁸ Alex Mills, *The Confluence of Public and Private International Law: Justice, Pluralism and Subsidiarity in the International Constitutional Ordering of Private Law* (Cambridge, UK: Cambridge University Press, 2009).

¹⁵⁹ Michaels, "Post-Critical Private International Law", *supra* note 37 at 54.

¹⁶⁰ I.e., transnational, self-interested concessions, per Kingson, "Coherence of International Taxation", *supra* note 27.

¹⁶¹ I.e., of sorts, particularly where there are foreign aid connotations and re-distributive goals. See e.g., Meyerowitz, "Redistributive Global Tax", *supra* note 116.

reform rather than employing a principled legal framework, is consistent with a trend in transnational legal scholarship which moves away from private law study.¹⁶²

Some transnational legal scholars query “whether the methodologies of private international law can be used in any meaningful way in the context of transnational authority.”¹⁶³ “Transnational authority” as theorized has many shifting and elusive faces,¹⁶⁴ including and especially multinational enterprises, dealt with in this thesis *qua* tax units. The notion is that transnational non-state actors have risen to such prominence that their power rivals that of nation states, and their transnational nature makes them unregulatable by the nation states within whose purview regulation of business usually and historically fell.¹⁶⁵

3.4.1 OECD Picking Up ‘Borderless’ World Paradigm

The OECD and UN approaches fall in line, deliberately or not, with a transnationalist scholarly view that the nation state is growing increasingly obsolete because of the way digitalization and globalization have rendered state borders less prescriptive. An example of such discursive politics appears in the “two-pillar solution” proposed by the OECD IF on BEPS.¹⁶⁶

In Pillar One, market jurisdictions in certain industries will tax residual profits via destination-based cash flow taxes, or formulary apportionment, instead of the current source/residence paradigm. Pillar One applies to multinational enterprises (“MNEs”) exceeding certain turnover and profitability thresholds.¹⁶⁷ New “special purpose” nexus rules allocate “Amount A” to market jurisdictions from which a threshold of revenue is derived by the MNE.¹⁶⁸ Residual profits are allocated to market jurisdictions, i.e., “end market jurisdictions

¹⁶² Burrows, “Challenges for Private Law”, *supra* note 118; Burrows, *Thinking About Statutes*, *supra* note 118.

¹⁶³ Muir-Watt, “Theorizing Transnational Authority”, *supra* note 43 at 326; For discussions of “authority,” see Roger Cotterrell & Maksymilian Del Mar, eds., *Authority in Transnational Legal Theory: Theorising Across Disciplines* (Northampton, MA: Edward Elgar Pub, 2016) [Cotterrell and Del Mar, *Authority*].

¹⁶⁴ See examples at Muir-Watt, “Theorizing Transnational Authority”, *ibid* at 331.

¹⁶⁵ See e.g., Culver and Giudice, *The Unsteady State*, *supra* note 4; Recall also Dani Roderick’s conceptualization of countries’ “trilemma” where countries must essentially choose between sovereignty, global trade, and democracy: Roderick, *Globalization Paradox*, *supra* note 15 at xv-xxii and 187-206.

¹⁶⁶ Organisation for Economic Co-Operation and Development, “Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy” (OECD: 2021) [OECD 2021 Pillars Statement]; A “detailed implementation plan together with remaining issues will be finalised by October 2021”: OECD 2021 Pillars Statement at 1; OECD 2020 Pillars Report, *supra* note 7.

¹⁶⁷ OECD 2021 Pillars Statement, *ibid* at 1.

¹⁶⁸ OECD 2021 Pillars Statement, *ibid* at 1.

where the goods or services are used or consumed” based on revenue sourcing rules according to the type of transaction.¹⁶⁹ Resulting double taxation is to be resolved via exemption or credit.¹⁷⁰

Pillar Two anticipates a global minimum tax by closing the door to low-tax incentives in countries that employ them. According to the OECD, members’ agreement on Pillar Two “indicates the ambition of the IF members for a robust global minimum tax with a limited impact on MNEs carrying out real economic activities with substance”.¹⁷¹ Pillar Two applies to MNEs that meeting certain thresholds determined by the standards of country by country reporting.¹⁷² Pillar Two is comprised of domestic Global anti-Base Erosion Rules (or “GloBE” rules, themselves comprised of the Income Inclusion Rule (“IIR”) which taxes parent entities in respect of income earned by subsidiaries taxed at a low rate, and the Undertaxed Payment Rule (“UTPR”) to deny deductions or impose adjustments to catch low-tax income not caught by the IIR, each with a minimum rate of 15%¹⁷³) and a treaty based rule “that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate”¹⁷⁴ to derive an effective tax rate. Under this “common approach”, members of the IF are “not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided under Pillar Two, including in light of model rules and guidance agreed to by the IF” and “accept the application of the GloBE rules applied by other IF members including agreement as to rule order and the application of any agreed safe harbours”.¹⁷⁵ The OECD contemplated Pillar Two being “brought into law” in 2022 and effective 2023 through a model “subject to tax rule”,¹⁷⁶ transitional rules, and possibly a multilateral instrument.¹⁷⁷ Pillar Two focuses on what amounts

¹⁶⁹ OECD 2021 Pillars Statement, *ibid* at 2.

¹⁷⁰ OECD 2021 Pillars Statement, *ibid* at 2.

¹⁷¹ OECD 2021 Pillars Statement, *ibid* at 5.

¹⁷² OECD 2021 Pillars Statement, *ibid* at 4.

¹⁷³ OECD 2021 Pillars Statement, *ibid* at 3, 4.

¹⁷⁴ OECD 2021 Pillars Statement, *ibid* at 3.

¹⁷⁵ OECD 2021 Pillars Statement, *ibid* at 3.

¹⁷⁶ OECD 2021 Pillars Statement, *ibid* at 5: “IF members recognise that the STTR is an integral part of achieving a consensus on Pillar Two for developing countries. IF members that apply nominal corporate income tax rates below the STTR minimum rate to interest, royalties and a defined set of other payments would implement the STTR into their bilateral treaties with developing IF members when requested to do so. The taxing right will be limited to the difference between the minimum rate and the tax rate on the payment. The minimum rate for the STTR will be from 7.5% to 9%.”

¹⁷⁷ OECD 2021 Pillars Statement, *ibid* at 5.

to a global minimum corporate tax which in many ways appears to pre-empt the predicted death of the nation state by subjugating local uses of tax expenditures.

Taking transnationalist scholarly predictions proclaiming the death of the nation state to their natural and not so far-fetched extension,¹⁷⁸ its ideological offspring is a narrative of the irrelevance of legal structures and strategies that developed within and between those allegedly obsolete nation states,¹⁷⁹ i.e., national and bilateral mechanisms to reconcile competing tax claims and therein the application of divergent legal systems

3.4.2 Borders Still Relevant

The nation state is not dead. The nation state remains a central authority interface and birthplace of legal personhood,¹⁸⁰ notwithstanding the proliferation of other authority interfaces and the gaps in regulatory nets.¹⁸¹ The nation state cannot be obsolete when without it and its legal system, the multinational corporation itself would not exist. Muir Watt writes that “giant multinational corporations operating delocalized industries, leading the digital revolution [etc.]” are “merely creatures of private law and subject as such to the ordinary private international law tools and methods” and “still reminiscent in many ways of [their] pre-modern forms”.¹⁸² Muir Watt maintains the multinational enterprise’s growth does not diminish the role to be played by private international law, which includes conflict of laws. She writes:¹⁸³

[A]fter all, private international law pre-dates the modern state; it evolved informally to govern the competing ambitions of various entities, religious and secular, to extend their power over individuals with links to several territorial or personal jurisdictions, according to the idea that some kind of distribution of potentially overlapping authority was required.

¹⁷⁸ It seems there are (at least) two schools of nation state disapproval: first, e.g., Culver and Giudice, *The Unsteady State*, *supra* note 4, advancing ‘death of nation state’ narratives proclaiming nation state not relevant because borders are less prescriptive; second, e.g., Katharina Pistor, *The Code of Capital, The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton: Princeton University Press, 2019) [Pistor, *Code of Capital*], proclaiming that the nation state is not able to regulate its corporate spawn, so we should just do away with the legal systems. But without the nation (first camp) and the legal systems (second camp), there would be no corporation at all.

¹⁷⁹ See e.g., Culver and Giudice, *The Unsteady State*, *ibid*.

¹⁸⁰ See e.g., Fleur Johns, “Data Territories: Changing Architectures of Association in International Law”, (2017) 47 *Netherlands Yearbook of International Law* 107.

¹⁸¹ E.g., “transnational” authorities. See e.g., Cotterrell and Del Mar, *Authority*, *supra* note 163.

¹⁸² Although Horatia Muir-Watt does not touch taxation of these enterprises in this article, her view on these enterprises is applicable in the international tax context. MNEs as legal creations are relevant regardless of whether the enterprises are dealt with as the “governed” or the “governing” (as the authors in Cotterrell and Del Mar, *Authority*, *supra* note 163 do): Muir-Watt, “Theorizing Transnational Authority”, *supra* note 43 at 338.

¹⁸³ Muir-Watt, “Theorizing Transnational Authority”, *ibid* at 359.

If the nation remains relevant, then so do the legal structures and strategies that developed within and between nation states, specifically tailored to mediate the behaviours of those within, between, and across jurisdictions. Conflict of laws lives in domestic legal regimes that remain relevant because the nation state remains relevant. While there are overarching international agreements and conventions,¹⁸⁴ conflict of laws analysis plays out in domestic terrains through the decisions of local courts. The fact that there is no overarching, supreme legal order to deal with domestic legal systems in conflict does not thwart their resolution.

Is *de facto* (in fact) or *de jure* (in law) harmonization necessary when conflicts of tax law result from underlying conflicts of private law to which tax is accessory, and private international law which governs private law conflicts, facilitates harmonious intersection of multiple, divergent legal regimes without demanding their harmonization? In her recent book, *The Code of Capital*, Katharina Pistor says ‘no’:

[T]he alternative to deliberate harmonization of laws through the political process is legal and regulatory competition among states combined with private autonomy for the laws end users, who get to pick and choose what is best for them. For this to work, countries do not need to engage in laborious legal harmonisation projects regarding the contents of, say, contract or corporate law; They only need to put in place conflict of laws rules that endorse the choices that private parties make. These rules have the additional advantage that they are so arcane their passage ruffles few feathers in the day-to-day political process.¹⁸⁵

Scholars who are dismantling the notion that the nation state is obsolete and maintain the relevance of structures such as COL/col that emanate from nations show that supranational legal proposals that attempt to harmonize legal systems are not accurate responses to the current global order.

Acknowledging the international legal context in which tax systems are operating, it is time to rethink the necessity of the OECD’s supranational approach. COL/col principles already effectively ascertain a governing law in way that respects the primacy of the nation state. Given the adverse effect on state sovereignty that arise when the nation state is prematurely disregarded, and that reconciliation approaches achieve the same result of ascertaining governing law, reconciliation is preferable to supranational harmonization.

¹⁸⁴ E.g., OAS Treaty, *infra* note 211; Rome I Regulation, *infra* note 191.

¹⁸⁵ Pistor, *Code of Capital*, *supra* note 178 at 135.

4 Meaning of Conflict of Laws “Choice of Law” Principles

In the conflict of laws discipline, no governing law means no contract. Contracts without a governing law are “mere abstractions”.¹⁸⁶ “Contracts are incapable of existing in a legal vacuum” and must be attached to an overarching and underlying legal system to give meaning and parameters to the parties’ obligations.¹⁸⁷ Governing law, or choice of law, animates the whole contract because choice of law points to the legal system in which the contract is embedded, with its intersecting statutes and jurisprudence, amounting to and itself animating a societal system of e.g., implied rights obligations, legal logics, and defined terms.

The decision of the Court of Queen’s Bench in *Kiener v Kiener*¹⁸⁸ (“*Kiener*”) illustrates the point that historically, if the parties’ selection in a choice of law clause is valid, they are taken to select the whole legal regime, not just the bits and pieces of it that serve them on a *post-hoc* basis. *Kiener* was a family law case about the proceeds to be paid as spousal support pursuant to a marriage agreement. The plaintiff husband undertook to pay support to the defendant, his former wife. The plaintiff husband was resident in the UK and all of his assets were located there. The defendant wife was located in the USA. The issue was whether the plaintiff husband could discharge his obligations by paying support amounts net of withholding taxes, or if he must pay amount gross including withholding taxes. The former spouses chose the law of New Jersey as the governing law for their marriage contract. The court found the parties had made a legitimate choice in selecting New Jersey law, and in so doing must be taken to have understood the surrounding circumstances of the legal regime, i.e., that withholding taxes were owing on transfers between UK payors and USA recipients. In this, the court found the recipient defendant wife had implicitly agreed to accept the payments net of withholding taxes. The plaintiff husband was not required to gross-up his support payments in order to discharge his

¹⁸⁶ “*Star Texas*”, [1993] 2 Lloyd’s Rep. 445 (C.A.) (UK) [*Star Texas*]: cases tell us there has to be a choice of law in a commercial contract, because with no governing law, the contract is a “mere abstraction”. It is interesting to think about this where the treaty is a contract between countries. Without a way to resolve classification disputes, does the treaty have a governing law? What does that say about the bargain struck between the countries? Can they know what they bargained for? Conflict of laws cases would say no. But while like contracts, treaties are different/not bound by contract law jurisprudence. Domestic contract law did not develop with treaties in mind because courts cannot adjudicate treaties the same way they do contracts because courts do not have jurisdiction over the parties to a treaty the same way they have jurisdiction over contracting parties.

¹⁸⁷ *Amin Rasheed Shipping Corp v Kuwait Insurance Co*, [1984] AC 50 (HL) (UK) at 65 [*Amin Rasheed Shipping*]; Janet Walker and Jean Gabriel Castel, *Castel and Walker: Canadian Conflict of Laws*, 6th ed (Markham: LexisNexis Canada, 2005) [Walker and Castel, *Conflict of Laws*], §31.3(a)(iii) “Nature of the Parties’ Choice”.

¹⁸⁸ *Kiener v Kiener*, (1945-1953) 34 TC 346 (UK) [*Kiener*].

obligations to pay spousal support under the marriage contract. If parties make a legitimate choice of law clause, that choice animates the network of legal obligations, meanings, and terms in which the contract is embedded.

International conventions on conflict of laws and choice of law are also illustrative of the necessity of governing law. In Europe, the *Rome Convention* of 1980¹⁸⁹ set out uniform choice of law rules for contracts.¹⁹⁰ Its provisions were amended and set down in the *Rome I Regulation*¹⁹¹ applying “in situations involving a conflict of laws, to contractual obligations in civil and commercial matters”.¹⁹² Article 3 details the nature and scope of parties’ autonomy to choose governing law for their contracts. Article 4 contains choice of law rules where parties have not chosen a governing law or their choice is not effective. The *Rome I Regulation* has “universal application” and operates “whether or not it is the law of a Member State”¹⁹³ who voluntarily signs on. For all the countries that have joined the *Rome I Regulation*, it tells the courts of those countries the rules for choice of law in contract.¹⁹⁴ Joerges views the EU as a conflict of laws regime.¹⁹⁵

A governing law must be indicated, whether the parties expressly select their governing law through a choice of law clause or impliedly select their governing law by virtue of their contractual context, behaviour or intention.¹⁹⁶ In conventional commercial contract cases in

¹⁸⁹ *European Community Convention on the Law Applicable to Contractual Obligations*, 19 June 1980 (80/934/EEC) [*Rome Convention*].

¹⁹⁰ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(d)(f) “Rome I Regulation and OAS Convention”.

¹⁹¹ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(d)(f) “Rome I Regulation and OAS Convention”. *Rome Convention*, *supra* note 189, has since been developed into a Regulation, Regulation (EC) no. 593/2008 of 17 June 2008 [*Rome I Regulation*].

¹⁹² *Rome I Regulation*, *ibid*, art 1.

¹⁹³ *Rome I Regulation*, *ibid*, art 2.

¹⁹⁴ The *Rome I Regulation*, *ibid*, is strongly influenced by the common law, articulating the principles in a clear and codified way. While it is very similar to the common law, it does not replicate common law. Like how the Brussels Regulation is strongly influenced by the civil law of jurisdiction, with the common lawyers being in the minority: *Brussels Convention for the Unification of Certain Rules of Law Relating to Bills of Lading* (1924, as amended by protocols of 1968 and 1979) in Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.4(d)(iii) “Carriage of Goods by Sea”. In its common law influence, the *Rome I Regulation* initially drew a great deal from English commercial law, which has been widely admired throughout Europe. The choice of law rules in the civil jurisdictions, which vary from one country to another, have not come to the fore quite as much as the common law in its articulation.

¹⁹⁵ Christian Joerges, “Reconceptualizing the Supremacy of European Law: A Plea for a Supranational Conflict of Laws” in B Kohler-Koch and B Rittberger, eds, *Debating the Democratic Legitimacy of the European Union* (New York: Rowman & Littlefield, 2007) 311.

¹⁹⁶ *Star Texas*, *supra* note 186; See also J Scott Wilkie, “Transfer Pricing Aspects of Intangibles: The License Model” in Michael Lang, Alfred Storck, and Raffaele Petrucci, eds, *Transfer Pricing in a Post-BEPS World* (Alphen aan den Rijn: Kluwer Law International, 2016) 16 discussing Lon Fuller’s ideas on contract and damages.

Canada, the necessity of ascertaining the governing law implores a choice of law analysis.¹⁹⁷ First, identify and characterize the issue to which the foreign law applies, e.g., a contract. Second, identify the choice of law rule, meaning the law of the place to which the contract has the most connections either via express choice of law (e.g., parties' choice of law or choice of forum clause), implied choice of law (e.g., parties' behaviour or ascertainable intention); and if neither of these can be ascertained or sufficiently proved, "proper law of the contract" (e.g., legal and factual connections of the contract to a jurisdiction).¹⁹⁸ Third, ensure the choice of law is legitimate, meaning *bona fide* (i.e., connected, and if not connected, not evasive), legal (i.e., lawful in the jurisdiction where the contract is being adjudicated), and not contrary to public policy¹⁹⁹ (e.g., not part of a scheme to break the laws of another country). Once determined, foreign law must be established as a fact.²⁰⁰ Tax treaty distributive rules illustrate how tax treaties employ COL/col principles to ascertain governing law as the law of the place to which the contract has the most connections. Tax treaty anti-abuse rules demonstrate how tax treaties employ the COL/col requirements that choices of law be *bona fide*, legal, and not contrary to public policy.

4.1 Governing Law That is Most Connected to the Event

COL/col principles implore governing law be ascertained as the law of the jurisdiction that bears the most connective ties to the circumstances. Connective ties may be established based on the jurisdiction to which the contract bears the "closest and most real connections", or whether the contract primarily concerns land or persons which tip the scales in favour of one jurisdiction or the other.

¹⁹⁷ Walker and Castel, *Conflict of Laws*, *supra* note 187, Part 3: Choice of Law, and particularly ch 31 "Contracts".

¹⁹⁸ Note that renvoi has been rejected time and time again for determining the proper law of the contract: Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(a)(v) "Constraints on the Parties' Freedom to Choose the Proper Law", citing at fn 14, Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(d) "Content of the Proper Law, the Time Element, and Renvoi"; *Amin Rasheed Shipping*, *supra* note 187; *Re United Railways of the Havana and Regla Warehouses Ltd*, [1960] Ch 52 (CA) at 96-97, rev'd and no reference to this point [1961] AC 1007 (HL); *Rosencrantz v Union Contractors Ltd*, [1960] BCJ No 91, 23 DLR (2d) 473 (SC) at 478.

¹⁹⁹ *Vita Food Products Inc v Unus Shipping Co*, [1939] AC 277 (UK) [*Vita Food*] at 290.

²⁰⁰ Walker and Castel, *Conflict of Laws*, *supra* note 187, ch 7 "Proof of Foreign Law and Documents".

4.1.1 Establishing Governing Law Based on Closest and Most Real Connection

Where the contract does not reveal a legitimate express or implied choice of law by the parties to serve as an overwhelming connective factor, the court determines the choice of law.²⁰¹

Determining the proper law of a contract employs a “objective” test established in the Australian *Bonython* case:²⁰² “the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connection”.²⁰³ The Supreme Court of Canada adopted the *Bonython* test in *Imperial Life Assurance Co of Canada v Colmenares*.²⁰⁴ Under this test, the court ascertains how the parties intended their contract to operate (and importantly, not the law the parties intended to govern their contract) according to the law of the place to which the contract has its closest and most real connections.²⁰⁵ Relevant factors include “legal factors” including the style and legal concepts with which the contract was drafted, and geographic factors including the place where the contract was made or was to be performed.²⁰⁶ Whether a statute exists in one of the contending jurisdictions that would invalidate all or portions of the parties’ contract does not bear on the court’s objective analysis, even though such a statute would change the operation of the contract.²⁰⁷ The proper law of the contract is assessed as of the time the contract was made and so factors considered are limited to the factors ascertainable at the time the contract was made.²⁰⁸

The EU context reflects similar considerations in the *Rome I Regulation*, Articles 3 and 4.²⁰⁹ Article 3 sets out the nature and parameters of the parties’ freedom to choose the law that governs their bargains. Article 4(3) and 4(4) deals with “[a]pplicable law in the absence of

²⁰¹ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(c)(i) “The Closest and Most Real Connection Test”.

²⁰² *Bonython v Commonwealth of Australia*, [1951] A.C. 201 (P.C.) (Austl) [*Bonython*].

²⁰³ *Bonython*, *ibid* at 219.

²⁰⁴ *Imperial Life Assurance Co of Canada v Colmenares*, [1967] SCJ No 30, [1967] SCR 443.

²⁰⁵ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(c)(i) “The Closest and Most Real Connection Test” citing at fn 2, *Rossano v Manufacturers Life Insurance Co*, [1963] 2 Q.B. 352 [*Rossano*] compared the objective test and the “imputed intention test” and determined the objective test was the correct approach.

²⁰⁶ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(c)(ii) “Factors Considered” and additionally for an extensive list of factors and cases that have employed them,

²⁰⁷ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(c)(ii) “Factors Considered” citing at fn 8, *243930 Alberta Ltd v Wickham*, [1990] OJ No 1781, 73 DLR (4th) 474 (CA), leave to appeal to SCC refused, [1990] SCCA No 487; *Etlér v Kertész*, [1960] OJ No 568, 26 DLR (2d) 209 (CA) at 222 and *Kahler v Midland Bank Ltd*, [1950] AC 24 (HL) illustrating how the courts do not weigh whether statutes in a contending jurisdiction would invalidate the choice of law.

²⁰⁸ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(c)(ii) “Factors Considered”.

²⁰⁹ *Rome I Regulation*, *supra* note 191.

choice”. If the circumstances fall outside of the specific choice of law rules listed in Articles 3(1) or 3(2), Articles 4(3) and 4(4) provide as follows:²¹⁰

3. Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in paragraphs 1 or 2, the law of that other country shall apply.

4. Where the law applicable cannot be determined pursuant to paragraphs 1 or 2, the contract shall be governed by the law of the country with which it is most closely connected.

The *Inter-American Convention on the Law Applicable to International Contracts* (“OAS Treaty”) makes similar provisions.²¹¹ Also called the *Mexico Convention*, the OAS Treaty was signed by Bolivia, Brazil, Mexico, Uruguay and Venezuela to codify substantive choice of law rules according to the primary principles of party autonomy, the proximity principle, and general principles of international commercial law.²¹² Article 7 provides that the “contract shall be governed by the law chosen by the parties” expressly or impliedly. Article 9 deals with instances where the parties have not expressly or implied selected a governing law:

If the parties have not selected the applicable law, or if their selection proves ineffective, the contract shall be governed by the law of the State with which it has the closest ties.

The Court will take into account all objective and subjective elements of the contract to determine the law of the State with which it has the closest ties. It shall also take into account the general principles of international commercial law recognized by international organizations.

Nevertheless, if a part of the contract were separable from the rest and if it had a closer tie with another State, the law of that State could, exceptionally, apply to that part of the contract.

In diverse legal contexts the governing law, absent parties’ legitimate choice, is the law of the place to which the contract or event has the most connections.

4.1.2 Establishing Governing Law Based on Character of Event

Central to the conflict of laws discipline are the concepts of *in rem* and *in personam* jurisdiction. *In rem* jurisdiction flows from a sovereign state’s authority over land and is engaged in disputes

²¹⁰ *Rome I Regulation, ibid*, arts 4(3) and 4(4) (emphasis added).

²¹¹ *Inter-American Convention on the Law Applicable to International Contracts*, OAS Treaty Series No. 78 [OAS Treaty], arts 7 and 9.

²¹² Department of International Law, Secretariat for Legal Affairs, Organization of American States, “The *Inter-American Convention on the Law Applicable to International Contracts* and the Furtherance of its Principles in the Americas” (Washington: Organization of American States, 2016), 2-5.

concerning land. *In personam* jurisdiction flows from a sovereign state's authority over persons and is engaged in disputes concerning persons.

4.1.2.1 Meaning of In Rem jurisdiction

In rem jurisdiction drives the choice of law for disputes about property and rights associated with property. "The basic rule is that the power of courts to act directly upon immovables is limited to those within the territory in which they sit".²¹³ Rights associated with immovables are treated the same way as immovables. In Canada, all estates, interests, and charges are considered immovables.²¹⁴ Canadian courts, for example, will not make decisions about title to foreign immovables,²¹⁵ nor the right to possess, partition,²¹⁶ nor make orders for the sale of foreign immovables.²¹⁷ The choice of law for immovable property is *lex situs*, i.e., the law of the

²¹³ Walker and Castel, *Conflict of Laws*, *supra* note 187, §23.1(a) "Foreign Immovables" citing at fn 17: *Duke v Andler*, [1932] 4 D.L.R. 529 (SCC) [*Duke*]; *Boucher-MacKay v MacKay*, [1983] PEIJ No 63, 34 RFL (2d) 366 (SC); *Re a Certain Lot in New Westminster District*, [1960] BCJ No 9, 32 WWR 388 (SC); *Tezcan v Tezcan*, [1987] BCJ No 2450 (CA) [*Tezcan*]; *War Eagle Mining Co v Robo Management Co*, [1995] BCJ No 2142 (SC), additional reasons at [1995] BCJ No 2884 (SC), further additional reasons at [1996] BCJ No 170 (SC) [*War Eagle*]; *Forsythe v Forsythe*, [1991] BCJ No 2101 (SC); *O'Hara v Chapman Estate*, [1987] SJ No 874 (CA); *Winnipeg Oil Co v Canadian Northern Railway Co*, [1911] MJ No 12 (CA); *Western Trust Co v Yoder*, [1945] SJ No 35 (KB); *McMahon v Waskochil*, [1945] O.J. No. 608 (HCJ); *Livingstone v Sibbald*, [1893] OJ No 220 (HCJ); *Hawks v Hawks*, [1921] SCJ No 68 [*Hawks*]; *Catania v Giannattasio*, [1999] OJ No 1197 (CA) [*Catania*]; *Southeast Toyota Distributors Inc v Branch*, [1998] BCJ No 477 (CA); *Concerning Ontario v Mar-Dive Corp*, [1996] O.J. No. 4471 (Gen Div), Professors Castel and Walker write: "the court was of the opinion that the jurisdictional test of real and substantial connection adopted by the Supreme Court of Canada in *Morguard Investments v De Savoye*, [1990] SCJ No 135, [1990] 3 SCR 1077, was applicable to both judgments *in rem* and *in personam*. Location of the *res* certainly meets the test but there may now be other bases for the exercise of jurisdiction *in rem*. Historically, an action relating to land was local and the trial of such an action, in the common law courts, required a jury drawn from people living in the place where the cause of action arose. Even though the English Judicature Acts 1873-75 abolished rules of venue, the jurisdiction of the English courts has not been extended to the trial of suits relating to foreign land. For an historical analysis see *British South Africa Co v Companhia de Mocambique*, [1893] AC 602 (HL); *Hesperides Hotels Ltd v Aegean Turkish Holidays Ltd*, [1979] A.C. 508 (H.L.)": Walker and Castel, *Conflict of Laws*, *supra* note 187, §23.1(a) "Foreign Immovables" at fn 17.

²¹⁴ Walker and Castel, *Conflict of Laws*, *ibid*, §22.1(b) "Immovables" citing at fn 2 *Re Hoyles; Row v Jagg*, [1911] 1 Ch 179 (CA) at 183, 186.

²¹⁵ Walker and Castel, *Conflict of Laws*, *ibid*, ch 23 "Immovables".

²¹⁶ Walker and Castel, *Conflict of Laws*, *ibid*, §23.1(a) "Foreign Immovables" fn 1, citing *Ross v Ross*, [1892] O.J. No. 82 (HCJ); *Hawks*, *supra* note 213; *Macedo v Macedo*, [1996] OJ No 435 (Gen Div) [*Macedo*]; *War Eagle*, *supra* note 213; *Lauser v Lauser*, [1993] BCJ No 2817 (SC); *Parfitt, Re*, [2003] BCJ No 2755 (SC).

²¹⁷ Walker and Castel, *Conflict of Laws*, *supra* note 187, §23.1(a) "Foreign Immovables" fn 2 citing: *Grey v Manitoba & North Western Railway Co of Canada*, [1897] AC 254 (PC); *Chadwick v Hunter*, [1884] MJ No 5 (CA); *Strange v Radford*, [1887] OJ No 125 (HCJ); *Great North-West Central Ry v Charlebois*, [1899] AC 114; *Cowan v Cowan*, [1983] NSJ No 11 (TD); *Confederation Trust Co v Discovery Tower II Ltd*, 95 BCLR (2d) 309 at 314, 315 (CA); *Macedo*, *ibid*, cf *MacKay v Colonial Investment & Loan Co*, [1902] OJ No 194 (Div Ct); and *Cackette v Cackette*, [1980] PEIJ No 6 (SC). See also Walker and Castel, *Conflict of Laws*, *supra* note 187, §23.1(a) "Foreign Immovables" fn 3 citing: *Palmer v Palmer*, [1979] SJ No 435 (CA); *Tezcan*, *supra* note 213; *Kitzerman v Kitzerman*, [1992] BCJ No 2189 (CA); *Jeske v Jeske*, [1982] BCJ No 79 (SC); *Hanuse v Hanuse*, [1984] BCJ No

jurisdiction in which the property is located, characterized as such by *lex situs*,²¹⁸ with the location of *situs* determined by *lex fori*, i.e., the law of the jurisdiction in which the court hearing the dispute is located.²¹⁹ Said another way, land and interests in land in a country are classified by the laws of the country in which it is located.²²⁰ Consent of the parties or choice of law other than *lex situs* for disputes concerning land or interests in land are not granted.²²¹ Castel and Walker write:²²²

As a general rule, all questions concerning rights over immovables are governed by the *lex situs*, namely the law of the place where the immovable is situated because in the last resort land can only be dealt with in a matter that the *lex situs* allows. This applies not only to immovable situated in any of the common law provinces or territories but also immovable situated abroad, so far as Canadian courts have the jurisdiction to deal with them.

The choice of law rule for land and interests in land being *lex situs* ensures countries' exclusive ability to determine the fates of land, land interests, and land uses within their territorial bounds. The implication is that no other country's judgments about how land is dealt with in another country should carry the day.

4.1.2.2 Meaning of Jurisdiction Over Movable Property

Differences in the location of property and therefore choice of law arise depending on the legal character of that property, or legal substance of relationships in respect of that property.²²³ For

2977 (SC); *McCalla v McCalla*, [1980] SJ No 468 (QB). If judgement made to this effect, not enforceable: *Burns v Davidson*, [1892] OJ No 201 (Div Ct) but see *Jeske v Jeske*, [1983] AJ No 21 (QB); *Catania*, *supra* note 213.

²¹⁸ Walker and Castel, *Conflict of Laws*, *ibid*, §22.1(a) "Characterization and Terminology": "The application of the *lex situs* to the characterization of property as immovable or movable is an exception to the general rule that characterization is done in accordance with the *lex fori*. This exception is also found in Article 3078 of the Québec Civil Code."

²¹⁹ *Rossano*, *supra* note 205 at 379, 380, cited in Walker and Castel, *Conflict of Laws*, *ibid*, §22.2 "Situs of Property", fn 1.

²²⁰ Walker and Castel, *Conflict of Laws*, *ibid*, §22.1(b) "Immovables" and fn 1.

²²¹ Walker and Castel, *Conflict of Laws*, *ibid*, §23.1(a) "Foreign Immovables".

²²² Walker and Castel, *Conflict of Laws*, *ibid*, §23.2 "Applicable Law" citing at fn 1: *Genesee Mutual Insurance Co v Westman* (1852), 8 UCQB 487 (CA) (a foreign legislature cannot create a lien on a legal estate in Canada); *Duke*, *supra* note 213 at 538; *Dominion Bridge Co v British-American Nickel Corp*, [1924] OJ No 124 (SC); *Malo and Bertrand v Clement*, [1943] OJ No 237 (HCJ); *Barinds v Green & Silverman*, [1911] BCJ No 67; *Re Landry and Steinhoff*, [1941] OR 67 (HCJ); *Arnold v Fleming*, [1923] 1 DLR 1026 (Alta SC); *Minot Grocery Co v Durick & Nye* (1913), 10 DLR 126 (Sask); *Page Estate v Sachs*, [1990] OJ No 478, appeal dismissed in [1993] OJ No 269; *Jose v Riz*, 2009 BCSC 1075 (foreign immovable holding is determined pursuant to law of place where the foreign immovable is situated).

²²³ For example, determining the location of assets for administration, succession, duty, and tax purposes in Walker and Castel, *Conflict of Laws*, *ibid*, §22.2 "Situs of Property" at fn 2.

tangible movable property, the choice of law for the validity and effect of an assignment, or choses in possession such as for tangible physical objects, is *prima facie lex situs* of the chose.²²⁴ For intangible movable property, such as choses in action such as debts, patents, copyright, goodwill, stocks, and shares, the choice of law is the proper law of the debt or the chose.²²⁵ Notwithstanding the specific choice of law rules applicable to specific kinds of movable property, the choice of law for movable property generally conforms to the principle that the applicable law is that to which the event is most connected. In some contexts, movables are governed by *mobilia sequuntur personam*, meaning that “movables follow the person” such that the choice of law for the movable is the law of the domicile, residence or nationality of its owner.²²⁶

4.1.2.3 Meaning of In Personam Jurisdiction

Regarding *in personam* jurisdiction, jurisdiction over a dispute concerning a person depends on the community to which the person is most connected. *In personam* jurisdiction can be conceptualized as domicile or residence, each with utility for different elements of a conflict of laws analysis. In any event of the different ways of identifying personal law as either domicile or residence, identifying personal law requires identifying connecting factors between the person and the jurisdiction.²²⁷ In general, the applicable law will be the law of the place where the person bears the most connections.

4.2 Governing Law Must Be Legitimately Chosen

While parties to a contract have wide autonomy to choose the law that governs their bargain, their autonomy is not unlimited.²²⁸ In the *Vita Food* case, Lord Wright wrote of parties’

²²⁴ Walker and Castel, *Conflict of Laws, ibid*, §24.1(a) “Tangibles”.

²²⁵ Walker and Castel, *Conflict of Laws, ibid*, §24.1(a) “Tangibles”.

²²⁶ Walker and Castel, *Conflict of Laws, ibid*, §1.11(f) “Meaning of Some Maxims” and §24.1(1) “Tangibles” at fn 3.

²²⁷ Walker and Castel, *Conflict of Laws, ibid*, §23.1(a) “Foreign Immovables” fn 17. Professors Castel and Walker write that “the court was of the opinion that the jurisdictional test of real and substantial connection adopted by the Supreme Court of Canada in *Morguard Investments v De Savoye* ... was applicable to both judgments *in rem* and *in personam*”: Walker and Castel, *Conflict of Laws, supra* note 187, §23.1(a) “Foreign Immovables” fn 17 citing *Morguard Investments v De Savoye*, [1990] SCJ No 135, [1990] 3 SCR 1077.

²²⁸ See Alex Mills, “Rethinking Jurisdiction in International Law” (2014) 84:1 Brit YB Intl L 187 on the dangers of increasing party autonomy, but note that he does not comment on the limitation on party autonomy to choose law

expansive autonomy and its qualification, holding “it is difficult to see what qualifications are possible [for parties’ autonomy in choice of law], provided the intention expressed is *bona fide* and legal, and provided there is no reason for avoiding the choice on the ground of public policy”.²²⁹ The requirement that choices of law be *bona fide* generally requires choice of law must not be used to evade the mandatory obligations of the law that would apply but for the choice of law. The requirement that choice of law be legal means that the choice of law must not violate the mandatory rules of the forum, i.e., the laws of the jurisdiction whose court is being asked to uphold the choice of law clause and the entitlements it affords. The requirement that a choice of law not be contrary to public policy demands that choice of law clauses not be used in conspiracies or arrangements which seek to contravene the laws of another state with which the contract bears connections.

4.2.1 Choice of Law Must be Bona Fide

If parties’ choice of law is not *bona fide*, the choice of law will be invalid for reasons of “improper motive”.²³⁰ One circumstance where choice of law will be *mala fide* for “improper motive”²³¹ is “where the parties select the law of the country with which the contract has no connection whatever” and without good reason for the choice.²³² As the court wrote in *Bank of Montreal v Snoxell*²³³ (“*Snoxell*”) “[t]he parties cannot make a pretence of contracting under one law in order to validate an agreement that clearly has its closest connection with another law”.²³⁴

expressed in e.g., *Vita Food*, *supra* note 199 at 290 stipulating that parties’ choices of law must be *bona fide*, legal and not contrary to public policy.

²²⁹ *Vita Food*, *ibid* at 290 (emphasis added). But see *Boissevain v Weil*, [1949] 1 KB 482 (CA) [*Boissevain*, KB] at 490-491, *aff’d* without reference to the issue of the proper law [1950] AC 327 (HL); “*Fehmarn*”, [1958] 1 All ER 333 (CA) at 335, where Denning L.J. implied that the parties’ intention of the law to govern their bargain was but one factor in ascertaining the proper law of the contract, but not determinative.

²³⁰ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law”.

²³¹ In this, it appears “improper motive” is inferred from conduct and outcome rather than proved outright. As Michael Lang notes in the international tax environment “motives are impossible to prove: Michael Lang, “BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties” (2014) 74:7 *Tax Notes Int’l* 655 [Lang, “BEPS Action 6”] at 658. In this, it conflict of laws choice of infers “improper motive” from conduct and outcome rather than proved outright.

²³² Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” citing at fn 4, *Boissevain*, KB, *supra* note 229 at 490-91; *Re Helbert Wagg & Co Ltd’s Claim*, [1956] Ch 323 [*Re Helbert Wagg*] at 341; *Queensland Estates Pty Ltd v Collas*, [1971] Qd R 75 (Full Ct) [*Collas*] at 80, 81.

²³³ *Bank of Montreal v Snoxell*, [1982] AJ No 1018 at para 10, 143 DLR (3d) 349 (QB) [*Snoxell*].

²³⁴ *Snoxell*, *ibid* at 352.

Courts determine whether or not a choice of law is *bona fide* with reference to the law of the place to which the bargain bears the closest connections. Nexus acts like the barometer of first resort for detecting a *bona fide* choice of law.

Despite the strong statement in *Snoxell*, mere absence of connection is not usually enough, without more, to render a choice of law invalid for not being *bona fide*. Castel and Walker note that in no cases has a party succeeded in having a choice of law clause in a contract thrown out on the sole basis that the contract has no connection with the jurisdiction whose law they chose.²³⁵ In all cases surveyed by Castel and Walker in their treatise, the courts found the respective contracts' connection with their chosen law to be sufficiently substantial to "qualify the choice as *bona fide*",²³⁶ amounting to a low bar of what constitutes connection. Choice of law clauses are more likely to be found invalid if the unconnected law was chosen for a *mala fide* reason.

Unconnected law will be invalid for being chosen for a *mala fide* reason in cases where the selection is a "sham". Where choice of law does not reflect the parties' agreement it will be a "sham choice" and rendered invalid.²³⁷ In *2106701 Ontario Inc (cob Novajet) v 2288450 Ontario Ltd*,²³⁸ the parties' chose the law of Nova Scotia as the governing law for their contract. The parties could offer no reason for their choice besides Nova Scotia law being in the template from which the parties drafted their agreement. The court found the parties' choice of law not *bona fide* as it did not reflect their intentions.²³⁹

Unconnected law will also be invalid for not being *bona fide* where it was selected to achieve an evasive purpose. Parties cannot make unconnected choices of law for the purpose of evading mandatory obligations in the jurisdiction whose law would govern the bargain but for the choice of law. The evasion principle²⁴⁰ provides that "parties cannot choose a law for the

²³⁵ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) "Constraints on the Parties' Freedom to Choose the Proper Law".

²³⁶ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(a)(v) "Constraints on the Parties' Freedom to Choose the Proper Law" citing at fn 10, *Nike Infomatic Systems Ltd v Avac Systems Ltd*, [1979] BCJ No 1277 (SC) [*Nike Infomatic*]; *Snoxell*, *supra* note 233.

²³⁷ Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(a)(v) "Constraints on the Parties' Freedom to Choose the Proper Law".

²³⁸ *2106701 Ontario Inc (cob Novajet) v 2288450 Ontario Ltd*, [2016] O.J. No. 2289, 2016 ONSC 2673.

²³⁹ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) "Constraints on the Parties' Freedom to Choose the Proper Law".

²⁴⁰ The French civil tradition has a private international law doctrine of evasion known as *fraude a la loi*: JJ Fawcett, "Evasion of Law and Mandatory Rules in Private International Law" (1990) 49 Camb LJ 44 [Fawcett, "Evasion"] at 44, citing Audit, *La Fraude a la Loi* (1974); Graveson, (1963) II Haugue Rec, 53-54;

purpose of evading a mandatory rule of the law that objectively is most closely connected to their contract.”²⁴¹ In Canada, “mandatory rules” are “any statutory rules that, according to express or implied terms of the legislation, bind the parties notwithstanding that their contract is otherwise governed by the law of a foreign [country]”,²⁴² i.e., “rules the parties cannot contract out of.”²⁴³ Fawcett describes “evasion” as “showing a preference for the application of one country's law rather than that of another”, where such preference is shown “by going to another country in the expectation that that country's law will be applied to their affairs”.²⁴⁴ The English treatise *Dicey and Morris on the Conflict of Laws*, provides “[a]n evasive choice of law is unreal and unreasonable and therefore without effect”.²⁴⁵

Similarly in the EU, the *Rome I Regulation* provides that parties may not, via choice of law, contract out of obligations that would have been mandatory under the legal regimes that would otherwise apply.²⁴⁶ See Article 3(3):

Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.

In diverse legal contexts, choice of law other than the law to which a contract is connected must not serve the purpose of evading, prejudicing, or otherwise circumventing the otherwise proper law of the contract, being the law that bears the most connections to the bargain.

²⁴¹ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” citing at fn 7: *Golden Acres Ltd v Queensland Estates Pty Ltd*, [1969] Qd R 378 (SC) [*Golden Acres*] but note that on appeal, the statutory regulatory rule prescribing *lex fori* applied: *Freehold Land Investments Ltd v Queensland Estates Pty Ltd* (1970), 123 CLR 418 (HC) [*Freehold Land Investments*]. See also *Greenshields Inc v Johnston*, [1981] AJ No 946 (QB), aff’d [1981] AJ No 695 (CA) [*Greenshields*]; *Nike Infomatic*, *supra* note 236 at para 11; *Vasquez v Delcan Corp*, [1998] O.J. No. 2833 (Gen Div) [*Vasquez*] at para 40; and *United Nations v Atlantic Seaways Corp*, [1979] FCJ No 71 (CA) [*Seaways Corp*] at para 27, each citing the “evasion” interpretation of *mala fide* choice of law but holding it inapplicable on the facts.

²⁴² Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(a) “Mandatory Rules of the Forum”.

²⁴³ Walker and Castel, *Conflict of Laws*, *ibid*, § 31.1 “Introduction”; See also Andrea Bonomi, “Mandatory Rules in Private International Law” (1999) 1 YB Priv Int’l L 215; Trevor C Hartley, “Mandatory Rules in International Contracts: The Common Law Approach” (1997) 266 Hague Rec 337, showing how other legal systems have progressed further than the common law in the articulation of mandatory rules.

²⁴⁴ Fawcett, “Evasion”, *supra* note 240 at 45.

²⁴⁵ JHC Morris, ed, *Dicey and Morris on the Conflict of Laws*, 9th ed (London: Stevens & Sons, 1973) [*Dicey and Morris on the Conflict of Laws*] at 730. According to Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” fn. 7: “The “evasion” concept was strongly argued in various editions of *Dicey*”.

²⁴⁶ *Rome I Regulation*, *supra* note 191, art 3(3); Walker and Castel, *Conflict of Laws*, *ibid*, §31.3(f) “Rome I Regulation and OAS Convention”.

4.2.2 Choice of Law Must be Legal

The “legality” requirement renders choice of law clauses invalid where a statute in the forum of adjudication forbids them,²⁴⁷ or alters the underlying contract law but for which the choice of law would be otherwise valid.²⁴⁸ Canadian courts, for example, must apply the express and implied rules and terms of statutes and legislation to which parties cannot contract out of and are subject to in any event of the parties choice of law.²⁴⁹

Some statutes forbid particular choices of law such as those enacting international agreements whereby states commit to require contracts of certain kinds contain certain uniform rules that cannot be derogated from.²⁵⁰ A statute which forbade particular choices of law appeared in the *Agro Co of Canada v “Regal Scout”* case (*Agro Co*).²⁵¹ In *Agro Co*, the court found the parties’ choice of law invalid because the choice of law had the ability to reduce the carrier’s liability to less than what was required under the Hague Rules. A federal statute of the forum court provided contracts could not include provisions which had the effect of reducing carriers’ liability to less than what was provided in the Hague Rules.²⁵² As a result, the choice of law providing for less liability than statutorily mandated was found illegal.

Other statutes legislatively alter the underlying contract law to which choice of law clauses must conform. For example, The UK’s *Unfair Contract Act 1977*²⁵³ alters the underlying

²⁴⁷ Walker and Castel, *Conflict of Laws, ibid*, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” citing at fn 11: *Agro Co of Canada v “Regal Scout”*, [1983] FCJ No 424 (TD) [*Agro Co*], following “*Morviken*”, [1983] 1 AC 565 (HL) (sub nom “*Hollandia*”).

²⁴⁸ Walker and Castel, *Conflict of Laws, ibid*, §31.6(a) “Mandatory Rules of the Forum”.

²⁴⁹ Walker and Castel, *Conflict of Laws, ibid*, §31.6(a) “Mandatory Rules of the Forum”.

²⁵⁰ Walker and Castel, *Conflict of Laws, ibid* 187, §31.6(a) “Mandatory Rules of the Forum” and fn 3, e.g, statutes that enact in domestic law the *United Nations Convention on Contracts for the International Sale of Goods* (1980), e.g., *International Conventions Implementation Act*, RSA. 2000, c 1-6; *International Sale of Goods Act*, RSBC 1996, c 236.

²⁵¹ *Agro Co*, *supra* note 247.

²⁵² For discussion of the Hague Rules, see J Fawcett, “Evasion”, *supra* note 240 at 49. Professors Castel and Walker notes that it is unlikely a choice of law would be rendered invalid according to the chosen legal regime. They write “[r]envoi has consistently been rejected as a technique for determining the proper law of a contract”: Walker and Castel, *Conflict of Laws, supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” and fn 14, §31.3(d) “Content of the Proper Law, the Time Element, and Renvoi”.

²⁵³ *Unfair Contract Act 1977*, (UK), c 50 [*Unfair Contract Act* (UK)], s 27(2).

English contract law by rendering invalid choice of law clauses that would otherwise carry the day but which would result in unfair exclusion or limitation clauses. The *Unfair Contract Act 1977* applies to foreclose unfair limitation or exclusion clauses even where parties have chosen governing law different than UK law where “the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act”.²⁵⁴ Another example altering the contract law for specific kinds of bargains appears in the Canadian *Bills of Exchange Act*,²⁵⁵ subjecting bills of exchange to particular choice of law rules other than that which would ordinarily apply at common law.²⁵⁶ Similarly, some Canadian provinces impose specific choice of law rules on contracts for insurance.²⁵⁷

Choice of law clauses that elicit behaviour that is illegal in the jurisdiction of performance will also fail the “legality” requirement. “Irrespective of its proper law, a contract will not be enforced to the extent that performance of it would be illegal in the jurisdiction where it was performed”.²⁵⁸ In the case of *Zivnostenska Banka National Corp v Frankman*, Lord Reid wrote, “I think it is now settled law that, whatever the proper law of the contract, an English court will not require a party to do an act in performance of a contract which would be an offence under the law in force at the place where the act has to be done”.²⁵⁹

The *Rome I Regulation* provides similarly.²⁶⁰ The *Rome I Regulation*, Article 9 provides that the mandatory rules of the jurisdiction where the contract is performed which would render the performance of the contract unlawful may be considered in determining its enforceability, operating through judicial discretion rather than imperative application.²⁶¹

1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

²⁵⁴ *Unfair Contract Act* (UK), *ibid*, s 27(2).

²⁵⁵ *Bills of Exchange Act*, RSC 1985, c B-4, ss 159-163 [*Bills of Exchange Act* (CA)].

²⁵⁶ *Bills of Exchange Act* (CA), *ibid*, ss 159-163. See also Walker and Castel, *Conflict of Laws*, *supra* note 187, ch 33 “Negotiable Instruments”.

²⁵⁷ Walker and Castel, *Conflict of Laws*, *ibid*, §31.4(g)(vii) “Insurance – Canadian Insurance Statutes”.

²⁵⁸ Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law”.

²⁵⁹ *Zivnostenska Banka National Corp v Frankman*, [1950] AC 57 (HL) at 79.

²⁶⁰ *Rome I Regulation*, *supra* note 191; Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law” and fns 14 and 15.

²⁶¹ *Rome I Regulation*, *ibid*, art 9 (emphasis added).

2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.

3. Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.

In Canada and elsewhere, the “legality” requirement demands choice of law comply with statutes and legislation in the relevant jurisdiction.

4.2.3 Choice of Law Must not be Contrary to Public Policy

In Canada, even if the parties have made a choice of law and their selection would be otherwise valid, the contract as a whole will be invalid if it violates Canadian public policy. Determining a violation of public policy does “not merely involve a definitional approach to the meaning of public policy but requires a consideration of all the dimensions of the case which carry implications for public policy”.²⁶² The standard for finding a violation of public policy is high and “turns on whether the foreign law is contrary to [a Canadian] view of basic morality”.²⁶³

“Making a contract that is part of a scheme to break the laws of another country has been held to be against public policy”.²⁶⁴ Castel and Walker write:

A contract that can be formed legally, but which is in fact part of a plan to contravene the law of another country, has been held to be unenforceable on the ground that to enforce it would be against international comity and thus violate the public policy of the forum.²⁶⁵

The Canadian civil law adopts a similar response, but goes even further. Article 3079 of the Quebec Civil Code²⁶⁶ gives courts discretion to reject choice of law clauses meant to circumvent legal obligations in the jurisdiction to which “the situation is closely connected”. The Quebec Civil Code provides:

²⁶² Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(b) “Obligation Invalidated by Public Policy” citing at fn. 7, *Society of Lloyd’s v Meinzer*, (2001) 55 OR (3d) 688 (CA) at para 66.

²⁶³ Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(b) “Obligation Invalidated by Public Policy” citing at fn 2: *Beals v Saldanha*, 2003 SCC 72 at para 71. In *Greenshields*, *supra* note 241 at para 32, Medhurst J wrote that “[t]he doctrine of public policy only seems to be invoked where the foreign law offends a principle of morality or justice which commands almost universal recognition”.

²⁶⁴ Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(b) “Obligation Invalidated by Public Policy” and §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law”.

²⁶⁵ Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law”.

²⁶⁶ *Civil Code of Quebec [CCQ]*, *supra* note 266, art 3079.

Where legitimate and manifestly preponderant interests so require, effect may be given to a mandatory provision of the law of another country with which the situation is closely connected.

In deciding whether to do so, consideration is given to the purpose of the provision and the consequences of its application.

In the historical European context, Article 7 (1) of the *Rome Convention* operated similarly to the conflict of law anti-abuse rules, reading (emphasis added):

When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.²⁶⁷

Similar once again, the *Mexico Convention* affords judicial discretion but nonetheless provides “it shall be up to the forum to decide when it applies the mandatory provisions of the law of another state with which the contract has close ties.”²⁶⁸

Choice of law clauses intended to act as intermediary regimes to achieve outcomes not legal under the law to which the contract bears closest connection fail the “public policy” requirement. In *Regazzoni v KC Sethia (1944) Ltd*²⁶⁹ (“*Regazzoni*”) public policy thwarted the parties’ choice of law because the choice of law formed part of a conspiracy to break the laws of another country. The contract concerned goods that had originated in India and were to be delivered to a European port. The parties selected English law to govern the contract. The court found it unenforceable upon ascertaining the parties’ intent to on-ship the goods to South Africa under the pretense of English law an attempt to covertly violate an Indian law that imposed an export prohibition not imposed by English law. In coming to its decision, the court applied *Foster v Driscoll*²⁷⁰ (*Foster*). That case concerned the sale of whiskey at a Scottish port. The court declined to enforce the contract upon finding that the parties’ intention was to smuggle the whiskey into the USA in contravention of USA prohibition laws. The Ontario Court of Appeal cited *Foster* in *Shiesel v Kirsch*,²⁷¹ a case bearing substantial similarities, namely, that it also involved plans to circumvent USA prohibition laws.²⁷²

²⁶⁷ *Rome Convention*, *supra* note 189, art 7.

²⁶⁸ OAS Treaty, *supra* note 211, art 11, para 2.

²⁶⁹ *Regazzoni v KC Sethia (1944) Ltd*, [1958] AC 301 (HL) [*Regazzoni*].

²⁷⁰ *Foster v Driscoll*, [1929] 1 KB 470 (CA).

²⁷¹ *Shiesel v Kirsch*, [1931] OJ No 390.

²⁷² Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law” and fn 8.

4.3 The Conflict of Laws “Revenue Rule”

In the interest of maintaining state sovereignty over domestic public policy, COL/col does not apply to all kinds of disputes. International taxation straddles public and private international law, the latter of which COL/col is a part. Notwithstanding, the prevailing view in private international law is that taxation is not private law, and so conflict of laws as a subset of private international law does not apply to taxation. This prevailing view implicitly accepts a stark division between ‘public’ and ‘private’ domestic law. Picking up on this stark division, in the conflict of laws jurisprudence concerning taxation, Canada and other common law jurisdictions adopt the common law ‘revenue rule’ and take the general position that foreign revenue laws, as public laws, are not justiciable in Canadian courts.²⁷³ The revenue rule has long stood to support the conclusion that taxation as the political instrument of revenue decidedly falls on the public side of the stark divide, providing as the normative basis a deferential posture to states’ public law, coupled with an understandable unwillingness of states to act as tax collector for a foreign government unless expressly agreed in a treaty. The *Rome I Regulation* containing uniform rules for choice of law in contract for European member states who sign on, contains a similar rule that the *Rome I Regulation* “shall not apply ... to revenue, customs or administrative matters”.²⁷⁴ Private international law scholars understand tax law as sitting decidedly outside the realm of domestic private law, and therefore decidedly outside the realm of private international law dispute resolution mechanisms, including conflict of laws.

Tax treaties allocate tax revenue and administrative burden between treaty countries with simultaneous legitimate taxing power. Allocative functions do not alone constitute an agreement to enforce, collect, or remit tax for the benefit of the treaty partner as would be foreclosed by the revenue rule.²⁷⁵ Some treaties provide for assistance in collection of tax, suggesting that allocative functions alone are not enough to amount to an agreement to enforce, collect, or remit tax for the benefit of the treaty partner. Interpreting tax treaties’ allocative provisions is not

²⁷³ *United States of America v Harden*, [1963] SCJ No 38 at paras 19-20; See also William Dodge, “The Public-Private Distinction in the Conflict of Laws” (2008) 18:2 Duke J Comp & Intl L 371.

²⁷⁴ *Rome I Regulation*, *supra* note 191, art 1 on the law applicable to contractual obligations.

²⁷⁵ Li, Cockfield and Wilkie, *International Taxation*, *supra* note 63 at 440-441.

synonymous with enforcing foreign revenue laws, so the revenue rule does not apply to foreclose conflict of laws principles as an interpretive aid or implicit thread in the treaty context.

5 Distributive Rules Using “Choice of Law” to Find Governing Law

Express choice of law clauses to select one governing law are essential if countries as parties in contracts want to have autonomy over the legal context which animates and informs their rights, and even have a contract at all. Before the treaty can operate to allocate taxing rights between the contracting states, the contracting states must ascertain the law that applies to give meaning to the specific provisions of their bargain. Without knowing the governing law of the specific provisions of their bargain, it is impossible to determine exactly what arrangement created and how it will operate. It is therefore not surprising that certain of the OECD 2017 Model Tax Treaty’s distributive rules contain implicit income-by-income governing law provisions.²⁷⁶ These choice of law distributive rules expressly provides which one of the contracting states’ respective laws should apply to determine the meaning and therefore treatment of various income types. The presence of governing law features in these clauses of the OECD 2017 Model Tax Treaty simultaneously acknowledges that conflicts of tax law result from an underlying conflict of private laws problem and seeks to solve it by allowing parties to ascertain the governing law.

5.1 Tax Treaties Ascertain a Single Governing Law

The OECD 2017 Model Tax Treaty goes to the trouble expressly providing whose law should apply in a template treaty designed for general use by a wide variety of countries. The fact that one law must be chosen no matter the treaty partners engaged in the bargain implies there is more than one law to choose from and that before the choice of one is made, two or more conceivably apply and that a choice of one is necessary for the treaty to function.²⁷⁷ Examples include rules for foreign tax recognition, dividends, and interest.

²⁷⁶ OECD 2017 Model Tax Treaty, *supra* note 23, is employed as examples considering they reflect articles before contracting states tinker or change them to reflect political goals and aims, and therefore reflects less variables.

²⁷⁷ Recalling again, Sasseville, “Schrödinger’s Cat”, *supra* note 33.

5.1.1 Foreign Tax Recognition Rules

Article 23A and 23B is a specific example of the imperative nature of governing law. As discussed above, Articles 23A and 23B contain foreign tax recognition rules that set out when contracting states extend credits or exemptions in the event of a qualification or classification conflict regarding how the treaty's terms should apply. Implicitly, Articles 23A and 23B of the OECD 2017 Model Tax Treaty endeavour to facilitate reconciliation by pointing either to self- and internally-executing choice of law rules (for qualification conflicts) or Mutual Agreement Procedure (for classification conflicts) whereby competent authorities engage in negotiations to devise bespoke governing law to apply in the particular circumstance. This in and of itself acknowledges the COL/col foundation that there is more than one legal meaning of a term at play and that in order for the bargain to effectively operate, the contracting states must identify a governing law for the dispute in question, whether through self-executing rules or bespoke law.

5.1.2 Dividends

Another example of express choice of law language in the OECD 2017 Model Tax Treaty distributive rules is found in Article 10. The inclusion of explicit choice of law wording in the OECD 2017 Model Tax Treaty in Article 10 represents an implicit acknowledgement that more than one legal system may apply to characterize the event, and that in order for the tax treaty to effectively operate in respect of that article, a single governing law must be indicated.

Article 10 deals with dividends. Article 10(1) provides that “[d]ividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State” but as per Article 10(2), withholding taxes may be set as negotiated by competent authorities for beneficial owners of the dividends. The term “dividends” is partially defined in Article 10 as the “income from shares, “jouissance” shares or “jouissance” rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident” (emphasis added). The OECD 2017 Model Tax Treaty contemplates treating “other corporate rights” as dividends if they are treated the same as dividends in the country from which payment pursuant to the other corporate right is paid, i.e., the law of the country with the prospective withholding tax claim. The fact that a choice of law for the meaning

of the term “dividend” is provided implies that other jurisdiction’s legal systems *could* apply to derive the definition, but expressly opts for the other to apply. Article 10 acknowledges and pre-emptively resolves a conflict of tax law issue by selecting a governing law for this article of the contracting states’ bargain.

Without the express choice of law wording in Article 10, it would be unclear what the contracting states meant by “income from other corporate rights”. Article 10 clears up the uncertainty by pointing to “the laws of the State of which the company making the distribution is a resident” to determine what other corporate rights are included in the meaning of “dividend” for the purposes of operation of Article 10. Without indication of the governing law for Article 10, the provision would be a “mere abstraction” just like contracts without a governing law as per the conflict of laws case, *Star Texas*.²⁷⁸ In including a choice of law clause to select the governing law, Article 10 appears aware of this.

5.1.3 Interest

The interest articles in Canada’s tax treaties with the USA and UK demonstrate how countries as parties indicate a choice of law. Article 11 of the OECD 2017 Model Tax Treaty concerns interest. Article 11(1) of the OECD 2017 Model Tax Treaty provides “[i]nterest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State,” but as per Article 11(2), withholding taxes are set at 10% or a figure by negotiation of competent authorities on the interest payment for beneficial owners of the interest. The term “interest” is fully defined in OECD 2017 Model Tax Treaty’s Article 11(3). However, in Canada’s tax treaties with the USA, the treatment extends to “income assimilated into income from money lent by the taxation laws of the Contracting State in which the income arises”.²⁷⁹ A legal determination is required, and therefore, a recourse to domestic law of one of the contracting states as governing law. Canada and the USA chose “the taxation laws of the Contracting State in which the income arises” and act as governing law.²⁸⁰ Canada and the UK similarly selected a governing law for the interest article in their treaty to the extent that “income assimilated to income from money lent” is determined according to “the taxation law of the State

²⁷⁸ *Star Texas*, *supra* note 186.

²⁷⁹ Canada-USA Tax Treaty, *supra* note 62, art 11(4).

²⁸⁰ Canada-USA Tax Treaty, *ibid*, art 11(4).

in which the income arises”.²⁸¹ Meaning of the treaty terms relies on its governing law because the governing law described what kinds of e.g., income, belongs to an income category, as is essential to allocate tax share between treaty states, as is the treaties’ function.

The express choice of law wording in Article 10 and Article 11 in the Canada-USA and Canada-UK treaty context acknowledges the concurrent contending claims of two or more legal systems but for a method of choosing one law to govern, and latently employs COL/col principles in order to do so.

5.2 Tax Treaties Ascertaining Governing Law With Most Connections to Event

Article 3(2)²⁸² of the OECD 2017 Model Tax Treaty also endeavours to ascertain one governing law bearing the closest connections to the event implicitly employing COL/col principles. In the absence of explicit choice of law wording the applicable OECD 2017 Model Tax Treaty article, Article 3(2) steps in as the analog to an overarching, general choice of law clause. Article 3(2) provides undefined terms are to be determined according to the tax law²⁸³ of the country whose tax claim it is, and if the term does not exist in the tax law, at domestic private law of that country.²⁸⁴

Article 3(2) allows contracting states to ascertain the governing law for treaty provisions turning on undefined terms by imploring those undefined terms take the meaning they have at domestic tax law, which is an accessory to domestic private law, lodged within a greater

²⁸¹ *Convention Between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland, For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital Gains*, as signed on September 8, 1978 and amended by the Protocols signed on April 15, 1980 and October 16, 1985, art 10(5).

²⁸² See John F Avery Jones, “The Benefits of Article 3(2) of the OECD Model” in Guglielmo Maisto, Angelo Nikolakakis, John M Ulmer, eds, “Essays on Tax Treaties: A Tribute to David A Ward”, (Canadian Tax Foundation, IBFD, 2012/2013) 3; Nathan Boidman, “The Role and Influence of Tax Treaties and Domestic Law on the Design of Each Other” in Guglielmo Maisto, Angelo Nikolakakis, John M Ulmer, eds, “Essays on Tax Treaties: A Tribute to David A. Ward”, (Canadian Tax Foundation, IBFD, 2012/2013) 33; John Avery Jones, “OECD/International – A Fresh Look at Article 3(2) of the OECD Model” (2020) 74:11 Bull Intl T.

²⁸³ Art 3(2) of the OECD 2017 Model Tax Treaty, *supra* note 23, operates so the governing law for the purposes of an undefined term in question is that of the jurisdiction asserting the tax claim, which necessarily engages the entire legal regime in which the derived tax treaty meaning is lodged. Private law serves as both the input and scaffolding for the tax system. Because of this, tax law incorporates by reference the overarching, greater legal system in which it and the private law which gives it life exist. Private law on the international stage is addressed through private international law, conflict of laws, and choice of law notions which broker the harmonious encounter of multiple, sometimes-divergent legal systems by prioritizing one over the other. In a choice of law analysis absent legitimate express or implied chosen law, the legal system with the closest connection to the dispute is the proper law, and the other contender defers and remains unaltered and unharmonized.

²⁸⁴ OECD 2017 Model Tax Treaty, *ibid*, art 3(2).

domestic legal system which characterizes persons, relationships, entities, etc. Because Article 3(2) directs undefined terms in the treaty be interpreted according to the domestic law of the country whose tax is in issue, Article 3(2) implicitly points to the domestic law most closely connected to the tax dispute to which the tax law is accessory to act as the governing law.

5.2.1 ‘Beneficial Ownership’ Cases

The mechanism of Article 3(2) for the harmonious intersection of multiple legal regimes contending to apply is apparent in cases on ‘beneficial ownership’. The term ‘beneficial ownership’ appears frequently in tax treaties but is not defined. The paucity of definition is significant because a company’s status as beneficial owner as opposed to a conduit is the basis on which some treaty benefits flow, e.g., withholding tax in respect of interest, royalties, and dividends. Beneficial ownership cases show how the power to define an undefined term goes to the country whose tax claim is in issue, and is therefore jurisdiction the most connected with the tax dispute. The cases of *Prevost Car Inc v The Queen*²⁸⁵ (“*Prevost Car*”), *Indofood International Finance Ltd v JP Morgan Chase Bank NA*²⁸⁶ (“*Indofood*”), and *Ministre de L’Economi, des Finances et de L’Indistrie v Societe Bank of Scotland*²⁸⁷ (“*Bank of Scotland*”) all resulted in judicial decisions intrinsically informed by the COL/col principles of closest connection.

Prevost Car employed Canadian law for a Canadian withholding tax claim. In *Prevost Car*, Canadian civil and common law meanings in corporate law were used to determine a Canadian withholding tax claim. A Netherlands company was interposed between Canadian, Swedish, and UK companies to facilitate the payment of dividends from the Canadian company to the Swedish and UK companies at a lower withholding tax rate. At the time, the Canada-Netherlands treaty provided 5% withholding tax, compared the 10% and 15% under the Canada-UK and Canada-Sweden treaty.

²⁸⁵ *Prevost Car Inc v The Queen*, 2008 TCC 231 [*Prevost Car TCC*] aff’d in 2009 FCA 57.

²⁸⁶ *Indofood International Finance Ltd v JP Morgan Chase Bank NA*, [2006] EWCA Civ 158 STL 1195 [*Indofood*]. For a more detailed summary of the case, see: Jinyan Li, Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity, *Comparative Research in Law & Political Economy*, Research Paper No. 4/2012 at 193 <https://digitalcommons.osgoode.yorku.ca/clpe/4>.

²⁸⁷ Conseil d’Etat, 29 December 2006, *Ministre de L’Economi, des Finances et de L’Indistrie v Societe Bank of Scotland*, no 283314 [*Bank of Scotland*].

Justice Rip acknowledged that “beneficial owner” is undefined in the tax treaty and the *ITA*. He determined that pursuant to Article 3(2) the term was to take the meaning it had at Canadian domestic private law. He considered the Canadian common law, income tax law, and the Civil Code of Quebec,²⁸⁸ and Dutch law aided by expert testimony. He said “Article 3(2) of the Tax Treaty requires me to look to a domestic solution in interpreting ‘beneficial owner’”²⁸⁹. He declined to devise an internationally consistent definition of the term.²⁹⁰

Justice Rip held the company interposed between the Canadian, Swedish, and UK entities was a beneficial owner based on the common law and civil law meanings of the term.²⁹¹ He noted that common law and civil law recognize that “the persons who ultimately receive the income are the owners of the income property”,²⁹² as opposed to conduits which could not be beneficial owners. Establishing Holdco was not a conduit, the door remained open for it to be a beneficial owner. “Beneficial owner” being undefined in respect of a Canadian tax claim, and Canadian law applied to determine the meaning of the treaty term. The effect was that the law that applied to bring meaning to the bargain was the law of the place to which the tax dispute was most connected, i.e., the country whose tax claim it was.

Indofood is another example of recourse to the domestic law of the country whose tax is in issue absent bespoke choice of law for the income type by the parties’ countries. *Indofood* concerned the application of Indonesian law for Indonesian withholding tax claim. The issue was whether (hypothetical) interest channeled through a (hypothetical) Netherlands company (hypothetically) interposed to gain benefits under Indonesia-Netherlands treaty was valid. *Indofood* was a contract case. The plaintiff was obligated by loan note terms to mitigate tax risk as a precondition to redemption. The defendant argued the plaintiff’s failure to insert a company to gain benefit under the Indonesia-Netherlands tax treaty amounted to a failure to mitigate tax risk and liability, was therefore in breach of its obligations, and thus no redemption was permitted. The court had to determine whether the plaintiff could have mitigated the tax risk by

²⁸⁸ *Prevost Car TCC*, *supra* note 285 at paras 97 and 98.

²⁸⁹ *Prevost Car TCC*, *ibid* at para 95.

²⁹⁰ *Prevost Car TCC*, *ibid* at para 95.

²⁹¹ Canada is a bijuridical country and as such, has two forum legal systems. *Bank of Scotland*, *supra* note 287 demonstrates how civil jurisdictions apply the civil law of the “abuse of rights” doctrine in a decidedly “substance over form” approach to restrain treaty abuse. *Prevost Car TCC*, *ibid*, illustrates common law Canada applying its hybrid common law/civil law meaning of beneficial ownership. Civil law and common law Canada will likely reconcile the same way they have reconciled other anti-avoidance rules. In Canada, applying domestic law as required by art 3(2) means finding a definition consistent across common law and civil law systems.

²⁹² *Prevost Car TCC*, *ibid* at para 99.

inserting a Netherlands company to gain benefit under the Indonesia-Netherlands tax treaty such that failure to do so rendered it in breach of the loan note terms.

The English Court of Appeal consulted information circulars from Indonesia, being the treaty country whose tax claim was hypothetically in issue, to overturn the English High Court's decision that the hypothetical Newco could have been a beneficial owner.²⁹³ The Court of Appeal held that the Newco could not be a beneficial owner, citing passages of the relevant OECD commentary and the information circular produced by the Indonesian tax authorities. Reliance on the Indonesian information circular amounts to an indirect and implicit reliance on Indonesian law to determine the meaning of beneficial owner, i.e., the law of the jurisdiction whose tax claim was hypothetically in issue.

Even though the case concerned an English contract and was heard in the English courts, the court considered the information circulars containing the law of the jurisdiction whose tax was in issue because the dispute concerned a hypothetical Indonesian tax claim. Consulting Indonesian law implicitly acknowledges Article 3(2)'s direction to the law of the jurisdiction with the closest connection to the tax dispute, i.e., the law of the jurisdiction whose tax claim (even if hypothetical) was in issue, to determine what the transaction was and what the significance of the transaction was.

Bank of Scotland concerned application of French law for a French dividend tax credit claim. A UK company was interposed between a USA company and its French subsidiary. The structure endeavoured to provide access to the dividend tax credit in the France-UK treaty. Such provision was absent from the France-USA treaty. The French Supreme Administrative Court (Conseil d'Etat) overturned the lower court decision, finding the UK bank was not the beneficial owner but a mere conduit interposed between the USA and French companies to access the dividend tax credit.

In overturning the lower court decision, the Conseil d'Etat re-characterized the dividends as interest. Showing attention to the question of 'what is the nature of the transaction, person, income, etc.?' and an implicit prioritizing of legal systems, the court viewed the case as a secured lending case, with shareholding acting as security for another financial transaction for

²⁹³ The Court of Appeal also cited commentary of Phillip Baker, who on the other hand, advocates an internationally-consistent fiscal definition not derived treaty parties' domestic laws, at *Indofood*, *supra* note 286 at paras 24, 34.

which interest, not dividends, were paid. In so doing, the court looked through the transaction and found the USA company remained the beneficial owner.

There is no legal concept nor legal meaning of beneficial ownership in French civil law. In France, treaty shopping through e.g., conduits, is abusive. The Conseil d'Etat's approach is consistent with France's "abuse of rights" doctrine commonly employed to resist treaty abuse.²⁹⁴ The doctrine allowed the court to look beneath the transaction to glean economic substance. The re-characterization amounts to the Conseil d'Etat applying French domestic law because re-characterizing the dividends as interest facilitated the look-through characteristic of the French abuse of rights doctrine. The court found the USA corporation remained the beneficial owner of the dividends, deciding the "beneficial ownership" issue from the perspective of treaty abuse available through application of its own domestic legal tools. In *Bank of Scotland*, French law was employed to determine the legitimacy of the French dividend tax credit claim.

Beneficial ownership cases show how Article 3(2) drives countries to ascertain governing law as the law of the place which has the closest connections to the tax dispute, i.e., the law of jurisdiction whose treaty the taxpayer seeks to access benefits under. In this, Article 3(2) thus directs determination of the facts, both legal and factual, toward the legal system with the closest connection.

5.3 Tax Treaties Ascertainning Governing Law Dependent on Character of Event

Some of the choice of law distributive rules contemplate and distribute of taxing rights between contracting states on the grounds of which legal system has the closest connection to the income along the lines of whether the income is fundamentally connected to land or to a person resembling COL/col concepts of *in rem* or *in personam* choice of law and adjudicative jurisdiction. The conflict of laws notions of *in rem* and *in personam* bear striking similarity to the source/residence paradigm in taxation. Countries wield tax claims over income from a source by virtue of the income's primary connection to the territory under the control of the country wielding the tax claim. Countries wield tax claims on the basis of residence by virtue of the

²⁹⁴ See e.g., Michael Byers, "Abuse of Rights: An Old Principle, A New Age" (2002) 47 McGill LJ 389 at 392 detailing the doctrine in civil legal systems such as Switzerland, France, Austria, Spain, Germany and Italy.

income's primary connection to a person subject to the authority of the country wielding the tax claim.²⁹⁵

5.3.1 Governing Law on In Rem Basis

The OECD 2017 Model Tax Treaty implicitly appreciates a country's exclusive right to determine rights and obligations in respect of land or land rights located within its jurisdiction by indicating choice of law is the country of source. Articles 6 and 13 contain express choice of law wording indicating choice of law for land and land rights as the country of source, in keeping with the COL/col *in rem* principle that choice of law for immovables is the law of the place where the land is located.

5.3.1.1 Immovable Property

Article 6(2) of the OECD 2017 Model Tax Treaty provides that “[t]he term “immovable property” shall have the meaning which it has under the law of the Contracting State in which the property in question is situated” (emphasis added). Articles 6(2) (emphasis added) and 6(3) respectively elucidate the meaning of “immovable property” such that “[t]he term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property” and “[t]he provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property”. In this, choice of law for the meaning of immovable property and the rights associated with the land and fixtures associated with the same are determined according to the law of the place where the immovable is situated, like the COL/col *in rem* jurisdiction concept.

5.3.1.2 Alienations of Immovables and Capital Gains

Article 13 of the OECD 2017 Model Tax Treaty employs an indirect choice of law along *in rem* lines by incorporating domestic law via Article 3(2). Because Article 3(2) provides that any

²⁹⁵ Avi-Yonah, “International Taxation of Electronic Commerce”, *supra* note 21 at 556.

undefined terms in the treaty be ascertained according to the law of the jurisdiction whose tax claim it is, to the extent of ambiguity in the definition of immovable property in the OECD 2017 Model Tax Treaty, Article 3(2) indirectly provides choice of law on an *in rem* basis for Articles 13(1) and 13(4).

Article 13 concerns capital gains and operates to ensure that alienations of capital property are taxed in the jurisdiction where they are most connected. While Article 13 does not contain an explicit choice of law paragraph, it is implicit in its acknowledgement and support of a contracting state's tax claim on an *in rem* basis. Article 13(1) and (4) are explicit that a contracting state has a tax claim to gains derived from dispositions of land, rights to land, and fixtures in its territory. Article 13(1) provides that “[g]ains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.” Article 13(4) expands the meaning of immovable property rights further to include shares that derive more than 50% of their value from immovable property: “[g]ains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State”.

The effect of Article 13(1) and (4) is that gains on the disposition of immovable property, which includes land, rights to land, and fixtures per the definition in Article 6, may be taxed in the jurisdiction where the land, rights to land, and fixtures are located. Given that Article 13(1) renders the tax claim to be that of the jurisdiction where the land, rights to land, and fixtures are located, and given Article 3(2) providing that any undefined terms in respect of the definition of immovable property or related rights will be determined according to the law of the contracting state who maintains a tax claim, the implicit choice of law is that of the jurisdiction where the land, rights to land, and fixtures are located. In this, the combined effect of Articles 13(1), 13(4) and 3(2) is the choice of law for undefined terms in respect of gains derived from disposition of immovable property is the jurisdiction where the land is located, i.e., the contracting state that would otherwise wield *in rem* jurisdiction.

By directly (in Article 6) or indirectly (in Articles 13(1) and (4)) providing that the governing law to derive the meaning of “immovable property” is to be determined by the laws of

the jurisdiction where the property is located, the OECD 2017 Model Tax Treaty adopts an approach consistent with the COL/col principle that issues concerning land and rights associated with land be determined only according the law of the place where they are located. While choice of law rules differ between jurisdictions, countries' respect for the principle that the lands of a jurisdiction be governed by its laws enjoys wide consensus.²⁹⁶ Sovereign jurisdictions have law-making power over the lands in their territory, and no one else's laws ought apply to them, including indirectly in and through the tax treaty context.

The OECD 2017 Model Tax Treaty's direction on which country's law should get to prescribe the meaning of "immovable property" acknowledges instances of tax system encounter as a choice of law problem, i.e., whose law determines what is meant by "immovable property", and proposes resolution for the problem directing that the governing law is the legal system with the closest connections on *in rem* lines, i.e., the legal system where the immovable property is located.

5.3.2 Governing Law on Movable Basis

The OECD 2017 Model Tax Treaty's treatment of movable property similarly follows a COL/col approach. The combined operation of Article 13(5) and Article 3(2) illustrates of the OECD 2017 Model Tax Treaty's implicit appreciation of COL/col regarding movable property.

5.3.2.1.1 Dispositions of Movable Property

Article 13(5) deals with gains flowing from the disposition property other than immovable property. Article 13(5) is explicit that "[g]ains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident". Consistent with the choice of law principles that the choice of law for disputes concerning movable property is the law of the jurisdiction where the movable property is most connected, the wide conception of Article 13(5) affords the tax right to the gains

²⁹⁶ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.4(c) "Contracts Regarding Immovable Property"; *CCQ*, *supra* note 266, art 3114(2) that unless the parties otherwise agree, choice of law for contracts concerning of sale of immovable property is the law of the place where the immovable is situated ; *Rome I Regulation*, *supra* note 191, arts 4(1)(c) concerning choice of law for contract concerning immovable property to be governed by the law of the place where the land is located; and, 11(5) regarding contracts concerning rights *in rem* to immovable property must comply with the mandatory formal requirements of the *lex situs* regardless of where the contract is executed. But there are exceptions in the common law world, see e.g., Walker and Castel, *Conflict of Laws*, *ibid*, §23.1(b) "Equitable Jurisdiction *In Personam*".

from disposition of movable property to the “Contracting State of which the alienator is a resident.” As movable, the property is not necessarily most connected to the territory in which it is located and may be most connected to the person who holds it. In allocating taxing rights in respect of movable property to the jurisdiction where the alienator is resident, any undefined terms in respect of the alienation of movable property are to be determined according to the law of the place where the alienator, analogous to the movable property rights holder, is located. This is consistent with the COL/col approach that the choice of law for disputes concerning movable property be the law of the jurisdiction where the event is most connected.

5.3.3 Governing Law on In Personam Basis

A country’s entitlement to residence-based taxation bears a striking similarity to *in personam* jurisdiction. Like jurisdiction over disputes concerning persons domiciled or resident in a jurisdiction, the right of a country to tax based on residence shifts depending on where the person establishes connections. Tax residents and COL/col residents or those domiciled in a jurisdiction both hold as part of their legal personality the capacity to move, to root, and to uproot. When they move and establish connections in a place, they come under the jurisdiction of the law of the place in which they are located, whether that jurisdiction is the tax jurisdiction of a country to tax the tax resident’s income, or the COL/col jurisdiction of a country to extend its law to a dispute concerning the person.

5.3.3.1 Employment Income and Benefits

Articles 15 and 18 how a person’s connection to a jurisdiction via employment may drive the OECD 2017 Model Tax Treaty’s allocation of choice of law. Article 15 concerns income from employment. Article 15(1) provides “salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State” but that “[i]f the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.” Article 15(2) describes the conditions for when the contracting state of residence has a taxing right to the employment income even though the employee performed the employment activities somewhere else. The conditions in Article 15(2) suggest that the contracting state of residence may only lay a claim to tax employment income earned in the contracting state of source if the

employee's remuneration for employment was not paid at a permanent establishment in the source country²⁹⁷ or if the employee was not employed by a resident of the contracting state of source.²⁹⁸ Article 18 follows a similar progression, providing that "pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State". The effect of Articles 15 and 18 is that the contracting state with the strongest connection to the employment relationship and employment activities maintains the right to tax the employee's income, with permanent establishment and employer residence acting as substantial factors. To the extent that there are undefined terms in the tax treaty in respect of that state's entitlement to tax employment income, Article 3(2) operates so that those undefined terms are determined according to the law of the contracting state of closest connection to the employment relationship and employment activities, effectively assigning governing law to the state with the closest connection consistent with choice of law principles.

While employment contracts are not necessarily claims *in personam*, the notion that the implicit choice of law for undefined terms in respect tax claims concerning employment income is the jurisdiction with the closest connection to the person and the person's employment activity and relationship is consistent with choice of law notions that absent a choice of law for an employment contract, the governing law or "proper law" is the law of the place where the employee mainly performs his or her duties,²⁹⁹ or in "cases in which the proper law was held not to be that of the country where the employee was working, were generally ones where the employee and the employer were both from one country and the posting to another country was one of limited duration or for a particular project".³⁰⁰ In this, Articles 15 and 18 of the OECD

²⁹⁷ OECD 2017 Model Tax Treaty, *supra* note 23, art 15(2)(c).

²⁹⁸ OECD 2017 Model Tax Treaty, *ibid*, art 15(2)(b).

²⁹⁹ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.4(h) "Employment Contracts" citing at fn 3: *Caglar v Moore*, [2005] OJ No 4606 (SCJ) (proper law was the law of the place of performance, i.e., Manitoba, even though the contract was made in Ontario); *Baranowski v Binks Manufacturing Co*, [2000] OJ No 49, 49 CCEL (2d) 170 (SCJ) (proper law was the law of the place of performance, i.e., Ontario, which was also the place of contracting); *Dallas Oilfield Contractors Ltd v Syroteuk*, [1980] SJ No 832 (Dist Ct) (proper law was the law of the place of performance, i.e., British Columbia, even though employer Alberta-based and was an employee a Saskatchewan resident).

³⁰⁰ Walker and Castel, *Conflict of Laws*, *ibid*, §31.4(h) "Employment Contracts" citing at fn 4: *Petroasia Energy Inc v Samek LLP*, 2008 ABQB 50, aff'd 2008 ABCA 323 (Alberta law held to apply re Alberta employer engaging employee for office set-up and to obtain oil and gas concessions in Kazakhstan); *Wilson v Metcalfe Construction Co*, [1947] AJ No 68 (TD), aff'd [1947] AJ No 69 (CA) (USA law held to apply USA citizen, serving in USA armed forces, working in British Columbia on USA government's construction of Alaska Highway, and engaged by Alberta contractor to do so); *Gagnon v Coopérative agricole du St-Laurent*, [1985] NBJ No 149 (QB) (proper law was Quebec law where employer and employee both resident in Quebec and employee engaged to work in New Brunswick in a business and directly controlled by management supervision in Quebec); *Vasquez*, *supra* note 241

2017 Model Tax Treaty show implicit appreciation of the COL/col principle that the governing law for employment matters is the law of the place with the closest ties to the employment relationship and activities.

5.4 Concluding on Distributive Rules

These distributive articles illustrate the different ways the OECD 2017 Model Tax Treaty acknowledges a conflict of tax laws and locates governing law as the legal system with the closest connections according to COL/col principles. Just as COL/col does, each choice of law distributive rule discussed endeavours to ascertain a single, most closely connected governing law. The presence of governing law features in the distributive articles of the OCED 2017 Model Tax Treaty simultaneously acknowledge an underlying conflict of laws problem and seek to solve it by ascertaining a governing law to characterize the subject of the dispute based on which contending legal system it has the closest connections to.

(Applicable law was Ontario law for Ontario resident contract-hire by Ontario company for work on project in Venezuela).

6 Anti-Abuse Rules Using “Choice of Law” to Find Governing Law

The implicit incorporation of COL/col principles also appear in the “minimum” standards to prevent “treaty shopping” and treaty abuse described in the OECD’s Action 6 Report³⁰¹ (“OECD 2015 Action 6 Report”) and reflected in the *Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting*³⁰² (“MLI”), the 2017 revisions to OECD 2017 Model Tax Treaty, and although pre-dating the OECD 2015 Action 6 Report, the Canada-USA Tax Treaty post-Fifth Protocol.

COL/col anti-abuse principles have, whether deliberately or not, found their way into the foundations of the anti-treaty shopping provisions in the MLI and OECD 2017 Model Tax Treaty. This is because at its core “treaty shopping” expresses the OECD’s frustration with improper express choices of private law, tax law, treaty law, and treaty benefits by corporate taxpayers. Conduit companies provide an illustrative example of treaty shopping as a COL/col problem.³⁰³

Consider an arrangement where a Canadian company must pay royalties to a company resident in Netherlands Antilles. Canada does not have a tax treaty with Netherlands Antilles, and so royalties paid by the Canadian company to the Netherlands Antilles company attract 25% withholding tax. In response, the Netherlands Antilles company incorporates a subsidiary in the Netherlands, the latter country with which Canada does have a tax treaty calling for a lesser 10% withholding tax, and assigns the newly-created Netherlands subsidiary its rights to receive the royalties. The newly-created Netherlands subsidiary is subject to the private laws of the Netherlands, the Netherlands tax laws as accessory to the Netherlands private law, and more specifically the Netherlands tax treaty law and related benefits it receives by being subject to Netherlands tax law as a resident, including the 10% withholding tax rate. The subsidiary uses its

³⁰¹ Organisation for Economic Co-Operation and Development, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report* (Paris: OECD, 2015) [OECD 2015 Action 6 Report].

³⁰² Organisation for Economic Co-Operation and Development, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, released November 24, 2016, and signed by Canada at Paris, France, June 7 2017 [MLI]; in Canada by Bill C-82, SC 2019, c 12; *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, SC 2019, c 12, Schedule in force December 1, 2019; *Multilateral Instrument in Respect of Tax Conventions Act*, SC 2019, c 12.

³⁰³ This example comes from *Velcro Canada Inc v The Queen*, 2012 TCC 57. Other examples include: *Prevost Car TCC*, *supra* note 285 re dividends channeled through Netherlands company interposed; *Bank of Scotland*, *supra* note 287, re dividends re-characterized as interest through UK company interposed *Indofood*, *supra* note 286 re interest channeled through Netherlands company interposed to benefit under Indonesia-Netherlands treaty. See the OECD 2019 Conduit Report, *supra* note 85.

access to the treaty benefits to access preferential tax treatment for others in the corporate group by acting as an intermediary in its transactions.

The act of creating an entity under the corporate law of a country enables the selection of the accessory tax law that will apply to that entity. Tax law being an accessory to private law, selection of private law implies an indirect selection of tax law, tax treaty law, and tax treaty benefits that flow from being a subject of the private law of a state. In arrangements like that in *Velcro* described above, the corporate group attempted to indirectly select the private law, tax law, treaty law, and treaty benefits that flow from being subject to the same for one of its newborn members. This is because as a resident, the newly created subsidiary is subject to the domestic corporate law, accessory tax law, and subset tax treaty law in the jurisdiction of its birth. This example shows an attempt to leverage an indirect choice of private law, tax law, and treaty law to realize the tax savings benefits of that choice of law and pass them onto other corporate group members through the newborn subsidiary serving as intermediary in cross-border transactions.

When a corporate taxpayer successfully engages in treaty shopping, it has effectively selected the private law, tax law, treaty law, and effective tax rates under the treaty. There is little difference between a company drafting a contract with a choice of law clause to provide that the contract is to be governed by the corporate laws of a country, and the same company incorporating a subsidiary in a jurisdiction such that the laws of that desired jurisdiction naturally apply in an intermediary fashion. The former is a direct choice of law. The latter is an indirect choice of law. Regardless of whether direct or indirect, the fact is that a choice of law is taking place.

Implicitly reflecting this dynamic, anti-treaty shopping provisions in the MLI and the OECD 2017 Model Tax Treaty employ the COL/col anti-abuse approach, foreclosing parties' selection of law to govern a contract if such selection is not *bona fide*, not illegal, and is contrary to public policy.

The MLI, OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty (collectively, "the treaties") reflect the COL/col anti-abuse approach "*bona fide*" requirement because the treaties provide that if there is no proper basis in the taxpayer's nexus for selecting the chosen tax law, and the reason for choosing the selected law is evasive, as determined through legal tests, treaty benefits are denied. Articles 6 (preamble) and 7 (principal purpose test ("PPT")) and

limitation on benefits (“LOB”) anti-abuse rules) of the MLI and their equivalents in the OECD 2017 Model Tax Treaty set out indicia of connection and evasion reminiscent of COL/col anti-abuse “*bona fide*” requirement. Nexus acts as a sort of baseline through which to determine if a choice of a law is *prima facie bona fide*. If there is an identifiable nexus between the taxpayer and the legal regime, the treaty acknowledges that treaty shopping or treaty abuse is unlikely to be afoot. If there is no identifiable nexus between the taxpayer and the legal regime, the treaty tests for evasive conduct and if found, denies the choice of private law, tax law, treaty law, and treaty benefits on that basis. Accessing treaty benefits via another legal regime rather than the one that properly applies, i.e., treaty rates versus non-treaty rates, to the taxpayer is evasive of the laws the contracting state intends to impose on the treaty shopper.

The MLI, OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty reflect the COL/col anti-abuse approach “legality” requirement because the treaties deny treaty benefits to taxpayers whose selection of the chosen tax regime is not lawful in the forum where the taxpayer seeks to have its entitlement acknowledged, i.e., explicitly through domestic anti-avoidance rules and doctrines which the OECD and contracting states expressly acknowledge operate in tandem with the MLI, OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty, or through treaty-based anti-avoidance rules and doctrines imposing very similar standards to domestic anti-avoidance rules and doctrines such that violation of the treaty-based rules imply a violation of domestic rules.

The MLI, OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty also implicitly reflect the COL/col anti-abuse approach “public policy” requirement. Considering that income shall generally only be taxed once,³⁰⁴ “treaty shopping” behaviour implies the taxpayer is deliberately stepping outside of the laws that would otherwise apply due to genuine nexus but for the “treaty shopping” behaviour to access another regime, the latter applying to the exclusion of the former. COL/col principles provide that but for a legitimate express or implied choice of law, the proper law to govern an arrangement is the law of the place to which the arrangement bears the most connections.³⁰⁵ Stepping outside of the laws that would apply but for “treaty shopping” behaviour as a choice of law is a latent contravention of the “proper”, most closely connected

³⁰⁴ League of Nations, Single Tax Principle Report, *supra* note 22 detailing the League of Nations “single tax principle” still reflected in modern tax treaties.

³⁰⁵ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(c)(i) “The Closest and Most Real Connection Test”.

law by subjugating and subverting it in ways it was not intended to bend, in violation of its mandatory laws, including tax law and negotiated tax treaties forming part thereof. Arrangements which break the express and implied mandatory statutory rules of another state violate public policy, including by using chosen legal regimes as intermediaries to access benefits not afforded under the otherwise applicable “proper”, most closely connected law. In Canada and elsewhere, it is a mandatory rule to submit to the tax authorities of one’s country. Accessing benefits that one’s law expressly does not provide, i.e., because the treaty does not contain it, is an implicit violation of what one’s law does contain, because the taxpayer is stepping outside of what the law to which it is subject does contain to access something else beyond its bounds. In this, under the COL/col conception, “treaty shopping” choices of law form part of an arrangement to contravene the tax law and treaty law of another state rendering the choice invalid for reasons of public policy.

The MLI, OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty contain anti-treaty shopping provisions that endeavour to ensure corporate taxpayers are not able to choose the private law, tax law, and therefore applicable tax treaties and benefits, that apply to their transaction unless their doing so is, to use COL/col terms, *bona fide*, legal, and not contrary to public policy.

6.1 Preamble Revised to Reflect Anti-Treaty Shopping Purpose

The OECD 2015 Action 6 Report provides tax treaties should contain a “clear statement” that “the Contracting States, when entering into a treaty, wish to prevent tax avoidance and, in particular, intend to avoid creating opportunities for treaty shopping”.³⁰⁶ This recommendation sparked changes to the preamble of existing bilateral tax treaties through the MLI’s Article 6, and the preamble of OECD 2017 Model Tax Treaty on a go-forward basis. Revisions to the preamble are significant in part because they are “relevant to the interpretation and application of the provisions”.³⁰⁷

The preamble of the OECD 2017 Model Tax Treaty provides:

Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,

³⁰⁶ OECD 2015 Action 6 Report, *supra* note 301 at para 19; See David G Duff, “Tax Treaty Abuse and the Principal Purpose Test – Part 2” (2018) 66:4 Can Tax J 947 [Duff, “PPT Part 2”] at 950-955.

³⁰⁷ OECD 2015 Action 6 Report, *ibid* at para 73.

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)...

Duff compares the text of preambles in pre-OECD 2015 Action 6 Report tax treaties to the OECD 2017 Model Tax Treaty's preamble reflecting the OECD 2015 Action 6 Report changes.³⁰⁸ The former describes the purpose of the tax treaty as being to address “the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital,” whereas the latter makes a definitive specification, noting that contracting states intend their convention to advance “the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)”.³⁰⁹ The commentary to the 2017 OECD 2017 Model Tax Treaty reflecting these revisions is explicit about the purpose of the definitive specification:³¹⁰

The changes made expressly recognise that the purposes of the Convention are not limited to the elimination of double taxation and that the Contracting States do not intend the provisions of the Convention to create opportunities for non-taxation or reduced taxation through tax evasion and avoidance. Given the particular base erosion and profit shifting concerns arising from treaty-shopping arrangements, it was also decided to refer explicitly to such arrangements as one example of tax avoidance that should not result from tax treaties, it being understood that this was only one example of tax avoidance that the Contracting States intend to prevent.

Article 6 of the MLI provides that “Covered Tax Agreement[s] shall be modified to include the following preamble text:”³¹¹

Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions.)³¹²

³⁰⁸ Professor Duff also compares the differences in the titles at Duff, “PPT Part 2”, *supra* note 306 at 950: “Whereas the title of the 1963 and 1977 versions of the model convention referred to a convention “for the avoidance of double taxation with respect to taxes on income and on capital,” the title of the 2017 model convention refers to a convention “for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance”.

³⁰⁹ OECD 2017 Model Tax Treaty, *supra* note 23, preamble (emphasis added). See Duff, “PPT Part 2”, *supra* note 306 at 950.

³¹⁰ OECD 2017 Model Tax Treaty, *ibid*, I-7 at para 16.1.

³¹¹ *MLI*, *supra* note 302, art 6.

³¹² *MLI*, *ibid*, art 6.

Parties may only reserve the right to omit this exact text from their covered tax agreements if their tax treaty preambles already contain language “describing the intent of the contracting jurisdictions to eliminate double taxation without creating opportunities for non-taxation or reduced taxation, whether that language is limited to cases of tax evasion or avoidance (including treaty shopping arrangements aimed at obtaining relief provided in the covered tax agreements for the indirect benefit of residents of third jurisdictions) or applies more broadly”.³¹³ In this, post-MLI preambles must contemplate and express intention to foreclose, at a minimum, treaty shopping and resultant extension of benefits for third-country residents. Considering the effect of contracting states’ recent and ascertainable intention as demonstrated through revised treaty terms on interpretation of the treaty and its provisions, i.e., recent statements of intent ascertainable in commentaries and contemporaneous agreement being most probative,³¹⁴ the MLI’s requirement that countries adopt Article 6(1)’s exact text “in place of or in the absence of preamble language”³¹⁵ demonstrates the MLI’s attempt have the contracting states make clear their intention that their treaties endeavor to reduce and shall be interpreted to foreclose double non-taxation while ensuring that opportunities for non-taxation or insufficient taxation are not created, with treaty shopping at top of mind.³¹⁶

6.2 Preambles Reflecting “Choice of Law” Anti-Abuse Approach

Striking parallels exist between the revised preambles in the MLI and OECD 2017 Model Tax Treaty and the COL/col anti-abuse approach. Both are intolerant of direct or indirect choices of law that are not *bona fide*, not legal and are contrary to public policy.

³¹³ *MLI, ibid*, art 6(3).

³¹⁴ *Alta Energy TCC*, *supra* note 145 at para 83; *Prevost Car TCC*, *supra* note 285 at paras. 10-11; *Crown Forest Industries v The Queen*, (1995) SCR 802 [Crown Forest] at para 44; *Canada v GlaxoSmithKline Inc* [2012] 3 SCR 3 at para 20, and recently cited by the Federal Court of Appeal in *Marzen Artistic Aluminum Ltd v Canada*, 2016 FCA 34.

³¹⁵ *MLI, supra* note 302, art 6(2).

³¹⁶ The MLI’s preamble requirement implies that countries’ primary intention for their treaties be reflected as foreclosing non and insufficient taxation including at least, treaty shopping, however countries may also indicate the intention that their tax treaties be “further develop their economic relationships and to enhance their cooperation in tax matters”: *MLI, ibid*, art 6(3). While countries “may choose to include” enhancement of economic relationships and tax cooperation in their preambles, it is not required, whereas the purpose of preventing non-taxation while foreclosing opportunities for treaty abuse is required.

6.2.1 Preambles Showing “Bona Fide” Requirement

The preambles implicitly incorporate the COL/col *bona fide* requirement. Where there is no nexus between taxpayers, income, and the treaty, the preamble is sensitive to evasive purposes that may drive taxpayers to select a tax and treaty law with which they have no nexus, and denies the choice of law in such circumstances.

The preambles are explicit that treaty benefits do not extend to “residents of third states”, as impliedly contrasted with residents of contracting states, implying that treaty benefits ought only to flow to those connected to either of the contracting states. Castel and Walker note that parties’ choice of law will not be *bona fide* “where the parties select the law of the country with which the contract has no connection whatever” and without good reason for the choice.³¹⁷ Similar to the COL/col anti-abuse approach, the preambles’ notion of nexus suggests that parties’ choice of law should be in some way connected to the chosen law, less suspicions be raised and further inquiry into *mala fide* purpose behind the choice of law be required.

As the interpretive compass for the treaty, the preambles suggest that the subsequent treaty provisions be read with a mind to foreclosing “evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in [the tax treaty]”³¹⁸ by individuals who bear no nexus to the contracting states’ legal systems. Similarly, COL/col cases and scholarship suggest “that parties cannot choose a law for the purpose of evading a mandatory rule of the law that objectively is most closely connected to their contract”.³¹⁹ The case of *Kiener*, discussed above, is an example of the English court refusing arguments which would allow parties to contract out of international tax obligations such as withholding tax, suggesting income tax laws as “mandatory rules”.³²⁰ In Canada, “mandatory” income tax rules include the general anti-avoidance rule, which defines “tax benefit” to include “an increase in a refund of tax

³¹⁷ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” citing at fn 4 *Boissevain*, KB, *supra* note 229; *Re Helbert Wagg*, *supra* note 232 at 341; *Collas*, *supra* note 232 at 80, 81.

³¹⁸ Text is common across the OECD 2017 Model Tax Treaty, *supra* note 23 and MLI, *supra* note 302 preambles.

³¹⁹ Professors Castel and Walker says that while there is no case directly on point, this is what cases suggest. Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” citing at fn 7: *Golden Acres*, *supra* note 241, but note that on appeal, the statutory regulatory rule prescribing *lex fori* applied: *Freehold Land Investments*, *supra* note 241. See also *Greenshields*, *supra* note 241; *Nike Infomatic*, *supra* note 236 at para 11; *Vasquez*, *supra* note 241 at para 40; and *Seaways Corp*, *supra* note 241 at para 27, each citing the “evasion” interpretation of *mala fide* choice of law but holding it inapplicable on the facts.

³²⁰ Recalling the meaning of “mandatory rules” at “4.2.1.2. Choices of Law Must be *Bona Fide*”.

or other amount under this Act as a result of a tax treaty”.³²¹ “Treaty shopping” to circumvent mandatory laws that would otherwise apply fits the COL/col definition of evasion proposed by Fawcett, “where laws are evaded by persons showing a preference for the application of one country's law rather than that of another”, where such preference is shown “by going to another country in the expectation that that country's law will be applied to their affairs”.³²² Just as the English treatise *Dicey and Morris on the Conflict of Laws*, provides “[a]n evasive choice of law is unreal and unreasonable and therefore without effect”,³²³ the preamble urges that third country residents be denied treaty benefits in the face of evasive choices of tax and treaty law via planning.

6.2.2 Preambles Showing “Legality” Requirement

The preambles impose, whether deliberately or not, the COL/col “legality” requirement. To be legal, choices of law must not violate the law of the jurisdiction where the parties seek to enforce their choice of law clause and have the entitlements flowing therefrom acknowledged. The preambles make explicit that as treaty partners, the contracting states intend to extend their treaty benefits to each other’s residents, and not to residents of third jurisdictions. This is not merely the contracting states’ intention, but in some cases, all that countries’ domestic law allows them to do. The Canadian context is illustrative. Canada’s Constitution provides that legislative authority and competence is divided between the provincial and federal governments along subject-matter lines.³²⁴ The federal or provincial government’s failure to observe the parameters of their legislative authority is unconstitutional and legislation wherein this occurs is invalid. In this, respect for the division of powers is thus imbued in all of Canada’s statutes. The legislature must not, as a latent feature in all of Canada’s statutes, extend its law-making competence beyond its scope of sovereign constitutional authority and competence. The Canadian *ITA* reflects such considerations. Canada’s domestic income tax legislation provides that its income tax laws are not to extend beyond those properly identified as residents³²⁵ or those with

³²¹ *ITA*, *supra* note 125, s 245(1).

³²² Fawcett, “Evasion”, *supra* note 240 at 45.

³²³ *Dicey and Morris on the Conflict of Laws*, *supra* note 245 at 730. Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” at fn 7: “The “evasion” concept was strongly argued in various editions of *Dicey*.”

³²⁴ *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (UK), 1982, c 11, ss 91 and 91.

³²⁵ *ITA*, *supra* note 125, s 2(1).

sufficiently close connections to Canada in a way that is fiscally significant to the tax authorities, i.e., being employed in Canada, carrying on business in Canada, or disposing of taxable Canadian property.³²⁶ Tax treaties and the benefits extended under tax treaties are a subset of Canada’s tax laws.

Courts, one of the ultimate interpreters of tax treaties, must apply the express and implied rules and terms of statutes and legislation, i.e., that Canadian laws are only to extend to those whom Canada has legislated them to apply, that constrain the treaty’s application in any event of the taxpayer’s choice of tax law and treaty law.³²⁷ Canada’s tax laws including tax treaties and benefits as mandatory rules must not flow to those not properly subject to Canada’s laws. Constitutionally, it is not legal for Canada’s tax laws, which include treaty laws, to extend to those outside subjection to Canada’s laws.

In this, the preamble accords with Canada’s implicit domestic constitutional legal requirements, and in this the “legality” requirement in the COL/col anti-abuse approach, because it is Canadian law via the Constitution that Canada not allow its law, including tax law and subset tax treaty law and related benefits, to extend the boundaries of its sovereign jurisdiction, i.e., to extend legal obligations, or treaty benefits, to those to whom its law should have no business applying, being residents of third jurisdictions who are not connected to the jurisdiction but for planning designed to facilitate obtaining treaty benefits. To allow tax benefits to flow to third-country residents is theoretically an overextension of Canada’s commitment to have its tax laws and related benefits, including treaty benefits extend only to those properly within its tax base as domestic statutes, whether the *ITA* or statutes enacting treaties, provide. To deny benefits in these circumstances is to operate within the bounds of constitutional principles imbued in statutes, as such demonstrating implicit compliance with the “legality” requirement in the COL/col anti-abuse approach.

6.2.3 Preambles Showing “Public Policy” Requirement

The preambles further require that indirect choices of tax law not be contrary to public policy, implicitly adopting the COL/col posture that otherwise-legal arrangements will be contrary to public policy if they form part of a plan to break the laws of a country with which the

³²⁶ *ITA*, *ibid*, s 2(3).

³²⁷ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(a) “Mandatory Rules of the Forum”.

arrangement has connections in fact. The preambles expressly acknowledge the treaty partners' commitment to eliminate double taxation without creating opportunities for nil or insufficient taxation, demonstrating their aliveness to the fact that efforts to reduce double taxation can simultaneously create opportunities for nil or insufficient taxation. The methods identified as "tax evasion or avoidance" imply that some otherwise applicable law is being evaded or avoided when the taxpayer brings itself out of the tax net in which they would otherwise be caught by avoiding the laws that would otherwise apply to them but for the specifically named "treaty shopping arrangements". As the court wrote in *Snoxell*, "[t]he parties cannot make a pretence of contracting under one law in order to validate an agreement that clearly has its closest connection with another law".³²⁸ In Canada and elsewhere, it is a mandatory rule to submit to the tax laws of one's country. Bare compliance with the text of income tax provisions is not sufficient to relieve a person of tax liability.³²⁹ To attempt bare statutory compliance with an intention to evade attracts penalties under the Canadian *ITA*.³³⁰ Under section 239 of the Canadian *ITA* for example, it is an offence to have "wilfully, in any manner, evaded or attempted to evade compliance with [the *ITA*] or payment of taxes imposed by [the *ITA*]"³³¹ Tax laws of a country include the treaties to which its executive has agreed and that have been passed through its legislative process. "Third country residents" accessing benefits that its law expressly does not provide, i.e., because the tax treaty was not negotiated to extend such benefits, is an implicit violation of what the third country resident's law does provide, because the third country resident is stepping outside of what its law expressly provides to access something else beyond its bounds. Third country residents' intention to evade the law of the state whose laws would otherwise apply is an implicit contravention of those laws.

According to the conflict of laws "public policy" requirement, arrangements which break the express and implied mandatory rules of another state violate public policy. In this, "treaty shopping arrangements" as an arrangement to contravene the tax and treaty laws of another state violate public policy. The preambles are sensitive to this violation. Castel and Walker's words shine through the preambles. According to the preambles, legally-constituted resident

³²⁸ *Snoxell*, *supra* note 233 at para 10.

³²⁹ See e.g., *ITA*, *supra* note 125, ss 245 (general anti-avoidance rule) and 67 (specific anti-avoidance rule "reasonableness" test).

³³⁰ See e.g., *ITA*, *ibid*, ss 238(1) (statutory penalties for violating legal duties); 239 (fraud); 162 (failure to file, or filing incomplete returns); 163 (false information or omissions).

³³¹ *ITA*, *ibid*, s 239(1)(d).

companies, like “[a] contract that can be formed legally”,³³² but intending to avoid and therein contravene the tax laws of a third jurisdiction, similar to “a plan to contravene the law of another country,”³³³ will have treaty entitlements declined, just as a foreign-law-breaking choice of law clause and entitlements flowing therefrom “has been held to be unenforceable on the ground that to enforce it would be against international comity and thus violate the public policy of the forum”.³³⁴

The revised preamble, like COL/col anti-abuse approach, provides for the treaty’s interpretation so that treaty benefits are withheld where the taxpayer’s choice of tax and treaty law is not *bona fide*, not legal, and is contrary to public policy.

6.3 “Limitation on Benefits” to Address Treaty Shopping

The OECD 2015 Action 6 Report calls for treaty-based specific anti-avoidance rules, such as LOBs, to address “treaty shopping situations that can be identified on the basis of criteria based on the legal nature [of], ownership in, and the general activities of, certain entities”.³³⁵ In the OECD 2017 Model Tax Treaty,³³⁶ the MLI and the Canada-USA Tax Treaty,³³⁷ the LOBs

³³² Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law.”

³³³ Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law.”

³³⁴ Walker and Castel, *Conflict of Laws*, *ibid*, §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law.”

³³⁵ OECD 2015 Action 6 Report, *supra* note 301, para 20; One of the focuses of the Action 5 (countering harmful tax practices with a focus on improving transparency) was ensuring that taxpayers could only access the benefits afforded by preferential regimes, i.e., reduced tax rates, if they performed substantial activity in the jurisdiction. The report discussed an “Nexus approach” whereby profits are taxed in accordance with substantial activity. In IP regimes, taxpayers may access benefits, e.g., reduced rates on intangibles, proportional to the activities they performed in the jurisdiction, through analogs such as e.g., qualifying research and development expenditures that lead to earning IP income. IP regimes entrants must employ the nexus approach after June 30, 2016 with optional domestic grandfathering rules active until June 30 2021: Organisation for Economic Co-Operation and Development, *The Review of the BEPS Action 5 Standard on the Exchange of Information on Certain Tax Rulings* (Paris: OECD, 2015).

³³⁶ Arts 29(1)-(7) of the OECD 2017 Model Tax Treaty, *supra* note 23, describe the LOB. Contracting states can adopt a LOB that is simplified or detailed. The OECD 2017 Model Tax Treaty LOB is similar to the 2016 USA Model Convention: see United States, Department of the Treasury, United States Model Income Tax Convention, February 17, 2016, web: <www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf>. For summary, see David G Duff, “Tax Treaty Abuse and the Principal Purpose Test—Part 1” (2018) 66:3 Can Tax J 619 at 664-668.; Re “simplified” or “detailed” see the commentary to OECD 2017 Model Tax Treaty, *supra* note 23, C(29)-1.

³³⁷ Canada-USA Tax Treaty, *supra* note 62, art 29A. The Canada-USA Tax Treaty has long retained an LOB. Before the Fifth Protocol, *supra* note 62, amendments in 2007 the LOB only applied in respect of USA taxes. Following the Fifth Protocol, the LOB applies to Canadian taxes as well: Department of the Treasury, *Technical Explanation of the Protocol Done at Chelsea on September 21, 2007 Amending the Convention Between the United States of America and Canada With Respect to Taxes on Income and on Capital Done at Washington on September 26, 1980, as Amended by the Protocols Done on June 14, 1983, March 28, 1994, March 17, 1995, and July 29, 1997*

(collectively, “the LOBs”) operate as a set of rules describing the persons, income, and circumstances for which treaty benefits will flow. LOBs are generally divided into recognizable components.

6.3.1 Component 1: Prima Facie Nexus

The first component of the LOBs provide that tax treaty benefits only flow to a defined class of “qualified persons”. In the OECD 2017 Model Tax Treaty, the LOB extends treaty benefits only to residents of contracting states who are qualified persons defined in Article 29(2).³³⁸ MLI Articles 7(8) and 7(9) define a qualified person as an individual, a government agency of one of the contracting jurisdictions, a publicly traded entity, a not-for-profit organization, a retirement benefits organization, and an entity that invests funds for retirement benefits organizations if at least 50% owned directly or indirectly by qualified persons. The Canada-USA Tax Treaty provides that treaty benefits flow only to “qualified persons” per Article 29A(1)(a)³³⁹ as defined via in Article 29A(2) to include resident natural persons,³⁴⁰ government bodies of contracting states,³⁴¹ and estates.³⁴² The first component of the LOBs engage explicit “self-executing”³⁴³ notions of nexus, satisfaction of which treaty benefits will *prima facie* flow without more.

6.3.2 Component 2: Nexus In Fact

The second component of the LOBs provide additional rules to extend treaty benefits to resident persons with sufficient connection to one of contracting states even though they are not qualified persons.

(Washington: Department of the Treasury, 2007) [Technical Explanation] at 51. Article 25 of the Fifth Protocol replaces Article 29A of the treaty providing an updated LOB provision: Technical Explanation at 51. On July 10, 2008, the USA Treasury Department released a Technical Explanation for the Fifth Protocol of the Canada-USA Tax Treaty. Canada's Department of Finance indicated in a press release it agreed with the content of the USA Technical Explanation. The USA Technical Explanation thus amounts to a common technical explanation between Canada and the USA.

³³⁸ OECD 2017 Model Tax Treaty, *supra* note 23, art 29(1). Simplified or detailed LOB options may change who is included as qualified persons and who is not.

³³⁹ Except under circumstances provided at paragraphs 29A(3), 29A(4), and 29A(6): Canada-USA Tax Treaty, *supra* note 62, art 29A(1)(b)

³⁴⁰ Canada-USA Tax Treaty, *ibid*, art 29A(2)(a).

³⁴¹ Canada-USA Tax Treaty, *ibid*, art 29A(2)(b).

³⁴² Canada-USA Tax Treaty, *ibid*, art 29A(2)(f).

³⁴³ Technical Explanation, *supra* note 337 at 57.

In the 2017 OECD Model Tax Treaty, un-qualified persons will be entitled to treaty benefits if “engaged in the active conduct of a business in its state of residence and the income emanates from, or is incidental to, that business,”³⁴⁴ a “headquarters company”,³⁴⁵ if more than a certain portion agreed upon by the contracting states of that un-qualified person is owned by persons entitled to treaty benefits;³⁴⁶ or where the contracting states otherwise agree to grant the treaty benefits,³⁴⁷ or where the competent authority exercises discretion to extend treaty benefits in any event.³⁴⁸

The MLI extends treaty benefits to un-qualified persons where “the resident is engaged in the active conduct of business in the first mentioned contracting jurisdiction, and the income derived from the other contracting jurisdiction emanates from, or is incidental to, that business”, but does not include “operating as a holding company”, “providing overall supervision or administration of a group of companies”, “providing group financing (including cash pooling)”, and “making or managing investments, unless carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such”.³⁴⁹ Article 7(10)(b) carries on this thread and provides that where a resident of one contracting jurisdiction derives income themselves or through a connected person from business activity in the other contracting jurisdiction, tax treaty benefits will flow only if “the business activity is carried on by the resident in the first mentioned contracting jurisdiction to which the income is related is substantial in relation to the same activity or a complimentary business activity carried on by the resident or such connected person in the other contracting jurisdiction” as to be “determined based on all the facts and circumstances”. Article 7(10)(c) goes on to provide “activities conducted by connected persons with respect to a resident of a contracting jurisdiction to a Covered Tax Agreement shall be deemed to be conducted by such resident”. Article 7(11) provides that an un-qualified person is entitled to treaty benefits if for at least six months in a 12 month period, including the time when the benefit would have flowed, the “equivalent

³⁴⁴ OECD 2017 Model Tax Treaty, *supra* note 23, art 29(3). Similarly, the base erosion rule at 2017 OECD Model Tax Treaty, art 29(8)(b) of the OECD 2017 Model Tax Treaty, *supra* note 23 provides exceptions for where “the income derived from the other State emanates from, or is incidental to, the active conduct of a business carried on through the permanent establishment,” not including the enterprise’s own financial management services unless the enterprise is a bank, insurance company, or registered securities dealer.

³⁴⁵ OECD 2017 Model Tax Treaty, *ibid*, art 29(5).

³⁴⁶ OECD 2017 Model Tax Treaty, *ibid*, art 29(4)

³⁴⁷ OECD 2017 Model Tax Treaty, *ibid*, art 29(6).

³⁴⁸ Art 29(8)(c) of the OECD 2017 Model Tax Treaty, *ibid*.

³⁴⁹ MLI, *supra* note 302, art 7(10)(a).

beneficiaries” of the un-qualified person “own, directly or indirectly, at least 75% of the beneficial interest in the resident”.

In the Canada-USA Tax Treaty, corporate entities must also meet additional requirements beyond mere residency before treaty benefits will flow. For publicly traded companies, the “principal class of shares or units (and any disproportionate class of shares or units^[350])” must be “primarily and regularly traded” on one or more recognized stock exchanges.³⁵¹ For subsidiaries of publicly traded companies or trusts,³⁵² the subsidiary must have five or fewer publicly traded corporate qualifying persons owning directly or indirectly more than 50% of the aggregate vote and value of the shares and more than 50% of the vote and value of each disproportionate class of shares, excluding debt substitute shares³⁵³ in both cases. Similarly, not-for-profit organizations where “more than half of the beneficiaries, members or participants of the organization are qualifying persons” are entitled to treaty benefits.³⁵⁴ Benefit organizations are also deemed qualified persons and receive treaty benefits³⁵⁵ if they are resident trusts, companies, organizations or other exempt organizations described in Article 21(2) (exempt organizations) who are generally exempt from income taxation in the tax year in the contracting state where they are resident, operate exclusively to administer or provide pension, retirement or employee benefits,³⁵⁶ and “established for the purpose of providing benefits primarily to individuals who are qualifying persons, [or] persons who were qualifying persons within the five preceding years”. Organizations that earn income for not-for-profit or benefits organizations³⁵⁷ are also entitled to treaty benefits if their beneficiaries are qualified persons.

Like the MLI LOB, un-qualified persons may still be entitled to treaty benefits under the Canada-USA Tax Treaty in respect of “those items of income that are connected with the active

³⁵⁰ Technical Explanation, *supra* note 337 meaning “disproportionate” rights compared to the other shares, e.g., higher participation, dividends, etc.

³⁵¹ Canada-USA Tax Treaty, *supra* note 62, art 29A(2)(c). Stock exchanges defined in Canada-USA Tax Treaty, art 29A(5)(F)

³⁵² Canada-USA Tax Treaty, *ibid*, art 29A(2)(d) directing to art 29A(2)(c).

³⁵³ Technical Explanation, *supra* note 337 at 55: “debt substitute shares closed quote, as defined and subparagraph 5A to mean “term preferred shares” as shares received through processes of debt restructuring e.g., in financial difficulty or insolvency (s 248(1) of the *ITA*, *supra* note 125) and others which the competent authorities may agree.

³⁵⁴ Canada-US Tax Treaty, *supra* note 62, art 29A(2)(g).

³⁵⁵ Canada-USA Tax Treaty, *ibid*, art 29A(2)(h).

³⁵⁶ Being the criteria from Article 21(2), which Article 29A(2)(h) points to: Canada-USA Tax Treaty, *ibid*.

³⁵⁷ Canada-USA Tax Treaty, *ibid*, art 29A(2)(i).

conduct of a trade or business”.³⁵⁸ If resident un-qualifying persons or resident persons related³⁵⁹ to them are “engaged in the active conduct of a trade or business ... other than the business of making or managing investments, unless those activities are carried on with customers in the ordinary course of business by a bank, an insurance company, a registered securities dealer or a deposit-taking financial institution”, treaty benefits flow in respect of “income derived from the other Contracting State in connection with or incidental to that trade or business (including any such income derived directly or indirectly by that resident person through one or more other persons that are residents of that state), but only if that trade or business is substantial in relation to the activity carried on in that other state giving rise to the income in respect of which the benefits provided under this Convention by that other state are claimed”.³⁶⁰ “[C]onnection” means, e.g., the income is derived upstream, downstream, or parallel to the business activity in the other contracting state.³⁶¹ “[I]ncidental” refers to, e.g., income earned when a person in the state of source issues securities using the working capital of the resident to yield short-term investments.³⁶² Income may be earned in connection with or incidental to an active trade or business through a chain of ownership by wholly or partly owned resident subsidiaries as anticipated through use of the terms “directly or indirectly”.³⁶³

6.3.3 Component 3: Denying Treaty Benefits if Causing Base Erosion

The third component of the LOBs adds additional base erosion rules to address specific circumstances.

In the OECD 2017 Model Tax Treaty, Article 29(8) acknowledges “potential abuses may result from the transfer of shares, debt claims, rights or property to permanent establishments set up solely for [that] purpose in countries that do not tax, or offer preferential tax treatment to, the income from such assets”.³⁶⁴ In light of this the OECD 2017 Model Tax Treaty denies treaty benefits in circumstances where one contracting state considers income attributable to a

³⁵⁸ Technical Explanation, *supra* note 337 at 57-58.

³⁵⁹ Per USA *IRC*, *supra* note 127, §482, and *ITA*, *supra* note 125, s 251, per Technical Explanation, *supra* note 337 at 58.

³⁶⁰ Canada-USA Tax Treaty, *supra* note 62, art 29A(3) (emphasis added).

³⁶¹ Technical Explanation, *supra* note 337 at 58.

³⁶² Technical Explanation, *ibid* at 58.

³⁶³ Technical Explanation, *ibid* at 58.

³⁶⁴ According to the commentary to art 29(8) at OECD 2017 Model Tax Treaty, *supra* note 23, C(29)(81)-C(29)(82) at para 161.

permanent establishment located in a third country where the income is tax exempt, and provides that the other contracting state need not grant treaty benefits with regard to the income the former treaty country views as tax exempt.³⁶⁵

Article 29A(2)(e) of the Canada-US Tax Treaty investigates whether a company or trust meets “ownership and base erosion tests”. The ownership prong of the test requires that 50% or greater of the aggregate vote and value of the shares, and 50% or more of the vote and value of each disproportionate class of shares, in both cases excluding debt substitute shares, not be owned directly or indirectly by un-qualified persons.³⁶⁶ The ownership prong of the test looks through the “chain of ownership”³⁶⁷ to determine if un-qualified persons own, directly or indirectly 50% of the aggregate value of shares and shares that afford disproportionate rights.³⁶⁸ The base erosion prong of the test requires that “the amount of the expenses deductible from the gross income (as determined in the state of residence of the company or trust) that are paid or payable by the company or trust” directly or indirectly to un-qualifying persons must be less than 50% of the company's gross income for that period, being preceding fiscal period (or current fiscal period if this is the first fiscal period).³⁶⁹

Under the “derivative benefits” test at Article 29A(4) of the Canada-USA Tax Treaty, a company resident in one of the contracting states is entitled to benefits associated with dividends,³⁷⁰ interest,³⁷¹ and royalties³⁷² even if not considered a qualifying person at 29A(1) and (2) not satisfying the ownership and base erosion tests at 29A(3).³⁷³ “A derivative benefits test entitles the resident of a Contracting State to treaty benefits if the owner of the resident would have been entitled to the same benefit had the income in question been earned directly by that owner”.³⁷⁴ In order to satisfy the ownership portion of the test, 90% of the aggregate vote and

³⁶⁵ According to the commentary to art 29(8) at OECD 2017 Model Tax Treaty, *supra* note 23, C(29)(82) at para, 161.

³⁶⁶ A very similar test appears in Canada-USA Tax Treaty, *supra* note 62, art 29A(2)(e)(ii) for trusts.

³⁶⁷ To use the term from Canada-USA Tax Treaty, *ibid*, art 29A(2)(d).

³⁶⁸ The ownership prong of the test is not applied to publicly traded corporations, as per their specific inclusion as “qualified persons” in art 29A(c): “a company or trust whose principal class of shares or units (and any disproportionate class of shares or units) is primarily and regularly traded on one or more recognized stock exchanges”: Canada-USA Tax Treaty, *supra* note 62, art 29A(c).

³⁶⁹ Canada-USA Tax Treaty, *ibid*, art 29A(2)(e).

³⁷⁰ Canada-USA Tax Treaty, *ibid*, art 10.

³⁷¹ Canada-USA Tax Treaty, *ibid*, art 11.

³⁷² Canada-USA Tax Treaty, *ibid*, art 12.

³⁷³ Technical Explanation, *supra* note 337 at 59.

³⁷⁴ Technical Explanation, *ibid* at 59.

value of all of its shares, and at least 50% of the vote and value of any disproportionate shares, in both cases excluding debt substitute shares, must be owned directly or indirectly by a qualifying person or a person who has all of the following characteristics; 1) be a resident of a third country with whom Canada or the USA has a comprehensive income tax convention under which the third country resident is entitled to all the benefits provided under that third tax treaty, e.g., passing a LOB test if there is one; 2) would be a qualifying person as per Article 29A(2), or if the un-qualifying person had been a resident of Canada or the USA and seeks benefits only in respect of income connected to active trade or business, would have satisfied the “active trade or business” test per Article 29A(3); and 3) and would be entitled under the third tax treaty to a rate of tax on dividends, interest, and royalties that is “at least as low as the rate applicable under [the Canada-USA Tax Treaty]”. The base erosion prong of the test is the same as the base erosion test provided in Article 29A(2)(e), i.e., that “the amount of the expenses deductible from the gross income (as determined in the state of residence of the company or trust) that are paid or payable by the company or trust” directly or indirectly to un-qualifying persons must be less than 50% of the company’s gross income for that period, being the preceding fiscal period (or current fiscal period if this is the first fiscal period) to ensure that income receiving preferred tax treatment is not indirectly transferred in great swaths to un-qualified persons not entitled to receive benefits under the treaty.

In the LOBs, un-qualifying persons who do not satisfy any of the exceptions may seek discretionary relief from the competent authorities. Under the MLI, competent authorities may permit treaty benefits “taking into account the object and purpose of the Covered Tax Agreement, but only if such resident demonstrates to the satisfaction of such Competent Authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under the Covered Tax Agreement”.³⁷⁵ Under the Canada-US Tax Treaty, the competent authority determines the un-qualified person’s entitlement to tax treaty benefits “on the basis of all factors including the history, structure, ownership and operation of that person” and whether as per Article 29A(6)(a), “its creation and existence did not have as a principal purpose the obtaining of benefits under [the Canada-USA Tax Treaty] that would not otherwise be available” or as per Article

³⁷⁵ MLI, *supra* note 302, art 7(12).

29A(6)(b), “it would not be appropriate, having regard to the purpose of this article, to deny the benefit of this Convention to that person”.

6.3.4 LOBs Reflecting “Choice of Law” Anti-Abuse Approach

6.3.4.1 LOBs Showing “Bona Fide” Requirement

Choices of law with no nexus to the chosen jurisdiction must not serve an evasive purpose. The MLI, OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty LOBs implicitly reflect this requirement.³⁷⁶

First, The LOBs ascertain *prima facie* nexus and extend treaty benefits on that basis, analogous to how the COL/col approach does not further interrogate choices of law if the contract is connected to the chosen jurisdiction. The MLI’s LOB and the Canada-USA Tax Treaty’s LOB both begin by providing that benefits should only flow to “qualified persons” and enumerate *prima facie* instances of connection to one of the contracting states which are “unlikely to be used, as the beneficial owner of income, to derive benefits under the Convention on behalf of a third country person”,³⁷⁷ and so further testing is not generally required,³⁷⁸ e.g., natural persons, government entities, and estates.³⁷⁹ In these instances contracting states can more readily assume connection to a contracting state and therefore the treaty on the basis of residence and are unlikely to be used for treaty shopping purposes. Sufficient nexus may also be established through earning the income in the “active conduct of a business”³⁸⁰ or via “derivative benefits” through the chain of ownership as qualified person.³⁸¹ “The active trade or business test looks not solely at the characteristics of the person deriving the income, but also at the nature of the person’s activity and the connection between the income and that activity” and imposes “the substantiality requirement ... intended to prevent treaty shopping” and avoid instances where a third country investor could conduct a very small business in one contracting state, and seek to

³⁷⁶ The discussion centers on the MLI, *ibid*, and Canada-USA Tax Treaty, *supra* note 62, because they are fleshed out and demonstrate a notional and actual respective agreement.

³⁷⁷ Technical Explanation, *supra* note 337 at 52.

³⁷⁸ Unless the person receives income as the nominee of a third country resident at which time the benefits for that income would be denied under other articles of the Canada-USA Tax Treaty, *supra* note 62 requiring beneficial ownership status: Technical Explanation, *ibid* at 52.

³⁷⁹ Canada-USA Tax Treaty, *ibid*, arts 29A(2)(a) (natural persons), 29A(2)(b) (contracting state government entities), 29A(2)(f) (estates).

³⁸⁰ Canada-USA Tax Treaty, *ibid*, art 29A(3);

³⁸¹ MLI, *supra* note 302, art 7(10)(b); Canada-USA Tax Treaty, *ibid*, art 29A(2)(4).

have the yields from a much larger business in the other contracting state pass through at a tax-preferred rate.³⁸² The “active conduct of business test” and “derivative benefits test” imply that only if un-qualifying persons bear sufficient connection to one of the contracting states will treaty benefits be justified

Duff opines that the LOB in the OECD 2017 Model Tax Treaty is “designed to limit treaty benefits to residents of contracting states with substantive economic connections to that state and circumstances where entitlement to treaty benefits does not result from abusive tax treaty shopping”.³⁸³ Similarly, the Canada-USA Tax Treaty LOB “addresses the problem of “treaty shopping” by residents of third states by requiring, in most cases, that the person seeking benefits not only be a US or Canadian resident but also satisfy other tests”,³⁸⁴ identifies “persons whose residence in the other Contracting State is not considered to have been motivated by the existence of the Convention”, and limits the flow of treaty benefits on that basis.³⁸⁵ This sounds very much like the COL/col anti-abuse approach “*bona fide*” requirement that choices of law bear connection to the chosen law, and if not, do not serve an evasive purpose.

Next, the LOBs ascertain evasive purpose and deny treaty benefits, analogous to rejecting a choice of law in COL/col, if such is found. Where connection and unlikely use in treaty shopping cannot be assumed *prima facie*, heightened criteria apply to justify extension of treaty benefits, e.g., publicly traded companies and their subsidiaries,³⁸⁶ not-for-profit and benefit organizations,³⁸⁷ and un-qualified persons whom qualified persons directly or indirectly own a

³⁸² Technical Explanation, *supra* note 337 at 58-59; see e.g. re television sets) While the small business may be connected and incidental to the large business, the substantiality requirement imposes an additional threshold. Technical Explanation at 59: “Substantial” does not require “the trade or business be as large as the income generating activity” but the trade or business “cannot, however, in terms of income, assets, or other similar measures, represent only a very small percentage of the size of the activity in the other state”.

³⁸³ Duff, “PPT Part 2”, *supra* note 306 at 952.

³⁸⁴ Technical Explanation, *supra* note 337 at 51

³⁸⁵ Technical Explanation, *ibid* at 51

³⁸⁶ E.g., *MLI*, *supra* note 302, art 7(9); Canada-USA Tax Treaty, *supra* note 62, the additional tests imposed on publicly traded companies (art 29A(2)(c) re when treaty benefits can flow to publicly traded companies, that more than 50% of the voting power and value of the shares of a publicly traded company are traded with a reliable robustness on a recognized stock exchange): Technical Explanation, *ibid* at 53; subsidiaries of publicly traded companies or trusts (art 29A(2)(d)): E.g., Canada-USA Tax Treaty, *supra* note 62, art 29A(2)(c).

³⁸⁷ Canada-USA Tax Treaty, *ibid*, art 29A(2)(g)-(i). Specifically, the criteria for not-for-profit organizations (art 29A(2)(g)) indicate Canada and the USA’s sensitivity to nexus before extending treaty benefits as more than half of the beneficiaries, members or participants of the not-for-profit organization must be qualifying persons. The criteria for tax-exempt organizations, such as a not-for-profit trust, company, or organization, also indicate Canada and the USA’s sensitivity to nexus before extending treaty benefits as art 29A(2)(g)-(i) ensures the tax-exempt organizations not providing services to resident individuals of either contracting state do not receive benefits under the treaty. Both imply that treaty benefits should only flow where the tax-exempt entity maintains nexus to one of the contracting

50% share in for six months out of the 12 month period. Article 29A(e) of the Canada-USA Tax Treaty imposes the additional requirement of the ownership and base erosion test on some corporate taxpayers. The Technical Explanation provides “[t]he ownership/base erosion test recognizes that the benefits of the Convention can be [improperly] enjoyed indirectly not only by equity holders of an entity, but also by that entities’ obligees, such as lenders, licensors, service providers, insurers and reinsurers, and others”³⁸⁸ and that a Canadian or USA company could conceivably have its taxable income reduced to near nothing due to deductible amounts paid to a third country resident while enjoying tax exempt status by virtue of the convention in the other contracting state,³⁸⁹ in effect, allowing income to float a third country residence at minimal tax cost with no reciprocal benefit to the contracting state footing the bill.³⁹⁰ The ownership/base erosion test “requires that both qualifying persons substantially owned the entity and that the entity’s tax base is not substantially eroded by payments (directly or indirectly) to non-qualifying persons”³⁹¹ and employs “look through principles”³⁹² in respect of fiscally transparent entities deemed so under the laws of the residence state.³⁹³ The base erosion prong ensures that unqualified persons not entitled to receive benefits under the treaty, even if for example owning Canadian companies through a 50% ownership in a USA company where ownership is ultimately traced to a resident of a third state, do not receive benefits of the treaty indirectly by transfers. Article 7(12) of the MLI and Article 29A(6) of the Canada-USA Tax Treaty acts as a catch-all, allowing competent authorities to extend treaty benefits but only where both are satisfied that the arrangement does not serve a treaty shopping purpose.

The designs of the MLI, Canada-USA Tax Treaty and OECD 2017 Model Tax Treaty employ an approach of ascending interrogation: the less connection an entity has to the contracting states, the more likely and therefore more intense the inquiry into the entity’s possible treaty shopping purpose. Contracting states deny choice of tax law and resultant flow of treaty benefits where the chosen law is unconnected to the arrangement and selected to facilitate

states. Wherever art 29(2) renders a one a qualified person and allows treaty benefits to flow, there must be certain connection between the taxpayer, whether or not they are a “qualified person”, and a contracting state extending the treaty benefits.

³⁸⁸ Technical Explanation, *supra* note 337 at 56.

³⁸⁹ Technical Explanation, *ibid* at 56; See example regarding licenses for technology and royalties.

³⁹⁰ Technical Explanation, *ibid* at 56.

³⁹¹ Technical Explanation, *ibid* at 56.

³⁹² Technical Explanation, *ibid* at 56, introduced by the Protocol (e.g., new paragraph 6 of art 4).

³⁹³ Besides entities that are resident in the source state; See example 56 of Technical Explanation, *supra* note 337.

an evasive or contravening purpose. In this, the LOBs implicitly echo COL/col anti-abuse approach's requirement that choices of law, whether directly through clauses or indirectly through tax planning, be *bona fide*.

6.3.4.2 LOBs Showing “Legality” Requirement

LOBs implicitly incorporate the COL/col legality requirement which provides that parties' choice of law in a contract will not be valid if the choice of law violates the express and implied rules and terms of statutes and legislation to which parties are subject in any event of the parties choice of law, i.e., regardless of whether the parties have chosen a different governing law for their bargain.³⁹⁴ LOBs not only acknowledge that domestic anti-abuse rules exist alongside tax treaties, but suggest that domestic anti-abuse rules be employed to work in tandem with the treaty LOBs to address situations that the treaty does not, together forming a comprehensive anti-treaty abuse regime. Treaty benefits are denied if not legal according to domestic anti-abuse rules.

The OECD 2015 Action 6 Report from which the OECD 2017 Model Tax Treaty and MLI LOBs are inspired advised contracting states enact supplementary mechanisms to address conduit arrangements not covered by tax treaties, including “domestic anti-abuse rules or judicial doctrines that would achieve a similar result”.³⁹⁵ Pre-dating the OECD 2015 Action 6 Report, the Technical Explanation on Article 29A(7) of the Canada-USA Tax Treaty emphasizes this role for domestic anti-abuse rules. Article 29A(7) “permits a Contracting State to rely on general anti-avoidance rules to counter arrangements involving treaty shopping through the other Contracting State”, for example, in treaty shopping circumstances.³⁹⁶ For instance, the USA may apply “substance-over-form and anti-conduit rules” for suspected treaty shopping involving Canadian entities. The Technical Explanation's acknowledgement that domestic anti-abuse rules support the operation of an LOB is not unique to the Canada-USA Tax Treaty. The Technical Explanation states that the principle of contracting states being able to employ domestic anti-abuse law to target treaty shopping is “inherent in this Convention”, is “inherent in other tax conventions concluded by the USA or Canada,” and similarly endorsed by the OECD.³⁹⁷ In the

³⁹⁴ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(a) “Mandatory Rules of the Forum”.

³⁹⁵ OECD 2015 Action 6 Report, *supra* note 301 at para 22.

³⁹⁶ Technical Explanation, *supra* note 337 at 61.

³⁹⁷ Technical Explanation, *ibid* at 61.

USA, for example, domestic anti-abuse rules serve to “compliment the explicit anti treaty shopping rules of Article [29A]”.³⁹⁸ Canada and the USA expressly acknowledge that “anti-treaty shopping rules determine whether a person has a sufficient nexus to Canada to be entitled to benefits under the Convention” and that “anti-abuse provisions under USA domestic law determine whether a particular transaction should be recast in accordance with the substance of the transaction” implicitly suggesting that interrogation into “substance” will expose the nexus of the entity or income to the USA.³⁹⁹ The domestic anti-abuse rules surrounding the LOBs make it so that an entity resident in one of the contracting states that would be *prima facie* entitled to the benefits afforded by the convention still must satisfy the demands of domestic anti-abuse rules, e.g., business purpose, substance over form, step transaction or conduit principles or other anti-avoidance rules, providing an additional stop-gap.⁴⁰⁰ Engaging domestic anti-avoidance rules to support the efforts of the LOBs make compliance with the former part of a comprehensive regime on which the LOBs rely.

Acknowledging the LOBs in context as operating alongside and in tandem with domestic anti-avoidance rules to form a comprehensive regime, LOBs are illuminated not just as the provisions in a treaty, but part of a greater legal web that relies on domestic legal rules to deliver its purpose. In this greater legal web comprised of both domestic and treaty law, choices of tax and treaty law via planning must be permissible under both the LOB and domestic anti-abuse rules. The requirement that choice of law be valid under domestic law of the country asked to validate the choice of law clause cuts to core of the legality requirement found in the COL/col anti-abuse approach.

6.3.4.3 LOBs Showing “Public Policy” Requirement

In conflict of laws, choices of law which violate the laws of the state to which the contract has connections will fail “public policy” requirement. The court in *Snoxell* held “[t]he parties cannot make a pretence of contracting under one law in order to validate an agreement that clearly has its closest connection with another law”.⁴⁰¹ Taxpayers engage in treaty shopping arrangements under a similar “pretense”: choosing a tax and tax treaty law other than the tax and tax treaty law

³⁹⁸ Technical Explanation, *ibid* at 52

³⁹⁹ Technical Explanation, *ibid* at 52.

⁴⁰⁰ Technical Explanation, *ibid* at 52.

⁴⁰¹ *Snoxell*, *supra* note 233 at para 10.

which bears the closest connections to their arrangement in order to avoid the less favourable tax and therefore tax treaty outcomes flowing from submission to the tax and tax treaty law bearing the closest connections to their arrangement. Attempts to circumvent tax laws, even with strict compliance to statutory demands, inadvertently violates the tax laws of the country whose laws are being circumvented by the treaty shopping arrangement.⁴⁰²

Consider the example of Article 29A(d) of the Canada-USA Tax Treaty in the context of a Canadian or USA subsidiary of a publicly traded company whose publicly traded parent company or intermediate owners in the chain of ownership are residents of a third state and not residents of Canada or the USA.⁴⁰³ Treaty benefits would not flow to the USA or Canadian resident subsidiary to the extent of its fiscal transparency because its immediate or intermediate owners are not qualifying persons.⁴⁰⁴ The Technical Explanation is explicit that “by applying the principles introduced by the Protocol (e.g., paragraph 6 of Article [4]) in the context of this rule, one “looks through” entities in the chain of ownership that are viewed as fiscally transparent under the domestic law of the state of residence (other than entities that are resident in the state of source)”.⁴⁰⁵ Requiring that “each company or trust in the chain of ownership is a qualifying person”⁴⁰⁶ guards against corporate subsidiaries who are not owned by qualifying persons accessing treaty benefits. The look-through operates with the implicit effect of ascertaining if third-country residents are trying to contravene the tax laws of their own countries by subjecting income to another tax regime that principles of eliminating double taxation would render the only regime to apply.

In this, treaty shopping much resembles COL/col cases where parties make a choice of law which acts as an intermediary regime through which to access benefits not afforded under the law that would otherwise apply and fail on public policy grounds. In *Regazzoni*,⁴⁰⁷ the parties inserted unrelated English law to govern the sale of Indian goods to be exported to South Africa because Indian law prohibited export of goods to South Africa. The parties sought to use the English law to achieve what Indian law did not permit, and in effect, circumvent Indian law’s

⁴⁰² See e.g., *ITA*, *supra* note 125, ss 238(1) (statutory penalties for violating legal duties); 239 (fraud); 162 (failure to file, or filing incomplete returns); 163 (false information or omissions).

⁴⁰³ This example comes from the Technical Explanation, *supra* note 337 at 54.

⁴⁰⁴ Technical Explanation, *ibid* at 54.

⁴⁰⁵ Technical Explanation, *ibid* at 55.

⁴⁰⁶ Canada-USA Tax Treaty, *supra* note 62, art 29A(2)(d).

⁴⁰⁷ *Regazzoni*, *supra* note 269.

export prohibition. The parties' choices of an unrelated intermediary jurisdiction's law were held invalid by the English Court. These conflict of laws cases illustrate judicial treatment when the jurisdiction's own law is interposed as an unrelated intermediary in an arrangement to violate the law of the country with the closest connection similar to the parties' posture in the LOBs. Similar to the COL/col case holdings, contracting states will not tolerate the imposition of their tax and treaty law for the purpose of circumventing the laws of the country most connected to the dispute and which would otherwise apply, deny treaty benefits, and find the choice of tax and treaty law invalid, in an implicit mobilization of the COL/col anti-abuse approach "public policy" requirement.

6.4 "Principal Purpose Test" to Address Treaty Shopping

In addition to specific anti-avoidance rules like the LOB, the OECD 2015 Action 6 Report also advocated the next update of the OECD model tax treaty include "a more general anti-abuse rule based on the principal purpose of transactions or arrangements".⁴⁰⁸ The OECD 2015 Action 6 Report acknowledged that while the enumerated LOB rules contain "objective criteria" and therefore provide "more certainty" they cannot capture "other forms of treaty abuses".⁴⁰⁹ An example is transactions involving conduits where "a resident of a Contracting State that would otherwise qualify for treaty benefits is used as an intermediary by persons who are not entitled to these benefits".⁴¹⁰ To buttress the specificity of the LOB, the OECD 2015 Action 6 Report proposed the general anti-abuse rule, or "principal purpose test" which "incorporates the principles" that:

[T]he benefits of a tax treaty should not be available where one of the principal purposes of arrangements or transactions is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax treaty.⁴¹¹

In the 2017 OECD Model Tax Treaty, the PPT appears at Article 29(9):

Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that

⁴⁰⁸ OECD 2015 Action 6 Report, *supra* note 301 at para 19; See Duff, "PPT Part 2", *supra* note 306 at 950-955.

⁴⁰⁹ OECD 2015 Action 6 Report, *ibid* at para 19; See Duff, "PPT Part 2", *ibid* at 950-955.

⁴¹⁰ OECD 2015 Action 6 Report, *ibid* at para 20.

⁴¹¹ OECD 2015 Action 6 Report, *ibid* at para 19.

granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

The PPT appears in Articles 7(1)-(5) of the MLI. Article 7(1) is substantially similar to its equivalent in the OECD 2017 Model Tax Treaty:

Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

Duff describes the basic structure of the PPTs as containing three distinct tests: the “results test”, the “purpose test”, and the “object and purpose test”.⁴¹² The “results test” provides that in order for the tax treaty benefit to be denied, the arrangement or transaction must have “resulted directly or indirectly in [the] benefit”.⁴¹³ The “purpose test” requires that the tax treaty benefit be denied if it is “reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was one of the principal purposes” of the arrangement or transaction that resulted in the benefit.⁴¹⁴ The “object and purpose test” renders the PPT to not apply where “it is established that granting the benefit in these circumstances would be in accordance with the object in purpose of the relevant [treaty] provisions”.⁴¹⁵

6.4.1 PPTs Reflecting “Choice of law” Anti-Abuse Approach

6.4.1.1 PPTs Showing “Bona Fide” Requirement

In the COL/col anti-abuse approach, choices of law made for the purpose of evading mandatory rules are not *bona fide* and therefore not valid. The PPT implicitly adopts a similar posture by foreclosing the application of treaty provisions, amounting to mandatory rules, where taxpayers seek to leverage them outside of their object and purpose.

⁴¹² Duff, “PPT Part 2”, *supra* note 306 at 967.

⁴¹³ *MLI*, *supra* note 302, art 7(1); Duff, “PPT Part 2”, *ibid* at 967, with detailed discussion of the “results test” beginning at 968.

⁴¹⁴ *MLI*, *ibid*, art 7(1); Duff, “PPT Part 2”, *ibid* at 968, with detailed discussion of the “purpose test” beginning at 975.

⁴¹⁵ *MLI*, *ibid*, art 7(1); Duff, “PPT Part 2”, *ibid* at 968, with detailed discussion of the “object and purpose test” beginning at 985.

Under the PPT, taxpayers cannot choose a law for the purposes of evading the tax and treaty rules of the law that is most connected to their arrangement and which would otherwise apply but for their planning. In Canadian COL/col, “mandatory rules” are “any statutory rules that, according to express or implied terms of the legislation, bind the parties notwithstanding that their contract is otherwise governed by the law of a foreign”,⁴¹⁶ i.e., “rules the parties cannot contract out of.”⁴¹⁷ Tax laws, including the statutes that inevitably bring treaties into force, may be considered mandatory rules.⁴¹⁸

The PPT requires that taxpayers establish that the benefit under the convention (enabled by an implicit selection of tax and treaty law) accrued “in accordance with the object and purpose of the relevant provisions” of the covered tax agreement, being mandatory rules. This involves identifying the relevant treaty provisions,⁴¹⁹ determining the object and purpose of the treaty provisions,⁴²⁰ and assessing the facts. Ascertaining the object and purpose of a treaty provision involves “consider[ing] the text of the provision, construing its rationale or policy in the context of other treaty provisions, including the preamble, as well as extrinsic materials such as explanatory memorandums and commentaries (provided that the commentaries are not subject to any relevant reservations)”.⁴²¹ The facts and circumstances of the arrangements giving rise to the benefit tell the story of if the benefit accords with the object and purpose its extension was intended to create. If the benefit is not flowing “in accordance with the object and purpose of the relevant provisions” the arrangement is implicitly contravening a mandatory rule, i.e., the treaty provision which is to apply according to its object and purpose.

In COL/col, “parties cannot choose a law for the purpose of evading a mandatory rule of the law that objectively is most closely connected to their contract.”⁴²² This implies that but for

⁴¹⁶ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(a) “Mandatory Rules of the Forum”.

⁴¹⁷ Walker and Castel, *Conflict of Laws*, *ibid*, § 31.1 “Introduction”.

⁴¹⁸ See *Kiener*, *supra* note 188.

⁴¹⁹ Duff, “PPT Part 2”, *supra* note 306 at 986.

⁴²⁰ Duff, “PPT Part 2”, *ibid* at 989.

⁴²¹ Duff, “PPT Part 2”, *ibid* at 989; citing Frank A Engelen, *Interpretation of Tax Treaties Under International Law*, IBFD Doctoral Series vol 7 (Amsterdam: International Bureau of Fiscal Documentation, 2004) at 175; Reinout Kok, “The Principal Purpose Test in Tax Treaties Under BEPS 6” (2016) 44:5 *Intertax* 406-12 at 409 [Kok, “The Principal Purpose Test”]; and *Crown Forest*, *supra* note 314 re Canada’s approach to tax treaty interpretation and utility of interpretive memorandums and OECD model convention commentaries.

⁴²² See “4.1.1. Establishing Governing Law Based on Closest and Most Real Connection” for discussion of the conflict of laws determination on law “most closely connected” to the contract, parties and circumstances. Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.3(a)(v) “Constraints on the Parties’ Freedom to Choose the Proper Law” citing at fn 7: *Golden Acres*, *supra* note 241, but note that on appeal, the statutory regulatory rule prescribing *lex fori* applied: *Freehold Land Investments*, *supra* note 241. See also *Greenshields*, *supra* note 241; *Nike Infomatic*,

the choice of law clause, the “law that objectively is most closely connected to [the] contract” would apply. “Evading a mandatory rule” imposed by the law that would otherwise apply is analogous to obtaining a benefit not available under the law that would otherwise apply through subversive means or arrangements. Both the COL/col *bona fide* requirement and the PPT determine the benchmark for applicable law on a sort of “but for” basis. But for the choice of law via tax planning (in the PPT context) or express terms in a contract (in the conflict of laws context), what obligations would the taxpayer or party be subject to? The PPT queries, e.g., ‘but for the arrangement, what would the tax consequence be to the party?’. COL/col similarly queries ‘but for the choice of law, what would the legal obligations imposed upon the party be?’. In both cases, the analysis asks if the tax consequences or obligations have been evaded.

According to the OECD commentary, the purpose of the PPT is “to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons as opposed to arrangements whose principal objective is to secure a more favourable tax treatment”.⁴²³ In this, the PPT acts as a stop gap for other treaty articles, taking the approach that strict compliance with a treaty provision to access its benefits in a way not aligned with its object and purpose is the same as trying to evade the limits imposed by the treaty provision.

The PPT does not permit choices of tax and treaty law which evade mandatory rules, i.e., tax treaty provisions as inextricable from their imbued purpose, implicitly acknowledging the COL/col approach that choices of law must be *bona fide*, i.e., not evasive.

6.4.1.2 PPTs Showing “Legality” Requirement

For certain countries, the COL/col legality requirement is latent in the PPT because the PPT imposes the same approach and standard as those domestic anti-avoidance rules, such that arrangements foreclosed by the PPT will also be foreclosed by some domestic anti-avoidance rules.⁴²⁴ Many jurisdictions employ general anti-avoidance rules bearing substantial similarities to the PPT with the intention of preventing base erosion.⁴²⁵ Acknowledging those statutes, the

supra note 236 at para 11; *Vasquez*, *supra* note 241 at para 40; and *Seaways Corp*, *supra* note 241 at para 27, each citing the “evasion” interpretation of *mala fide* choice of law but holding it inapplicable on the facts.

⁴²³ Commentary on art 29 of OECD 2017 Model Tax Treaty, *supra* note 23, C(29)-86 to C(29)-87 at para 174.

⁴²⁴ Brown and Bogle, “Treaty Shopping and the *MLP*”, *infra* note 434.

⁴²⁵ Christophe Waerzeggers and Cory Hillier, “Introducing a General Anti-Avoidance Rule”, (2016) 1 Tax Law IMF Technical Note 8; See also Kok, “The Principal Purpose Test”, *supra* note 421 at 408 where the author consults Dutch jurisprudence and scholarship to glean the meaning of “object and purpose.”; Some argue the PPT could be contrary to the EU’s principle of legal certainty and gives tax authorities too much discretion: Dennis Weber, “The

OECD commentary to the PPT provides its intent is *inter alia* to “confirm” the role of a general anti-abuse principles “for States whose domestic law already allows them to address such cases”.⁴²⁶

Similar to the requirements of the PPT, the Canadian GAAR, for example, requires the existence of a tax benefit⁴²⁷, a “purpose test” to target only a transaction or series reasonably considered to be undertaken for *mala fide* purposes,⁴²⁸ and an “misuse or abuse test” limiting the application of the GAAR to where it can be reasonably considered that the transaction or series directly or indirectly results in misuse or abuse of the *ITA* or other statutes read as a whole.⁴²⁹ The purpose test and the abuse and misuse test appear in most modern GAAR rules.⁴³⁰ The UK’s general anti-abuse rule⁴³¹ queries purpose by defining targeted “tax arrangements” as arrangements that circumstances reasonably disclose to be the or a main purpose of obtaining a tax advantage, and queries abuse and misuse by engaging GAAR where the tax arrangement cannot reasonably be regarded as a reasonable course of action in light of the relevant tax provision including the extent that the results of the arrangement correspond with the provision’s principles, whether steps in the arrangement are “contrived or abnormal”, and “whether the arrangements are intended to exploit any shortcomings in those provisions”.⁴³² In another example, the European Court of Justice’s anti-abuse principle, codified in EU Council Directive, *Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market* requires member states “ignore [for the purposes of computing tax liability] an arrangement or a series of arrangements which, having been put into place for the main purpose

Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law” (2017) 1 Erasmus L Rev 48. Others imply this is not the case, noting the EU’s similar approach as the PPT: see David Duff, “Reflections on Tim Edgar’s “Building a Better GAAR” (2020) 68:2 Can Tax J 579 [Duff, “Tim Edgar’s GAAR”] at 582.

⁴²⁶ OECD 2017 Model Tax Treaty, *supra* note 23 at para 169.

⁴²⁷ *ITA*, *supra* note 125, s 245 (1) for the definition of tax benefit.

⁴²⁸ *ITA*, *ibid*, s 245(3).

⁴²⁹ *ITA*, *ibid*, s 245(3);

⁴³⁰ Duff, “Tim Edgar’s GAAR”, *supra* note 425 at 581, and fns 4-5 regarding exceptions to general inclusion of “purpose” and “abuse or misuse” elements in New Zealand and Australia’s GAARs; A recent survey of GAAR rules is found in Michael Lang et al, eds., *GAARs—A Key Element of Tax Systems in the Post-BEPS World* (Amsterdam: IBFD, 2016).

⁴³¹ *Finance Act 2013* (UK), 2003, c 29, s 206-215.

⁴³² See Judith Freedman, “Designing a General Anti-Abuse Rule: Striking a Balance” (2014) 20:3 Asia-Pacific Tax Bulletin 167 at 170.

or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances”.⁴³³

The PPT imposes a substantially similar bar to the domestic Canadian GAAR and GAARs similar to it. Brown and Bogle reviewed cases decided by the operation of GAAR, hypothesized the outcomes had the cases been decided by the operation of the PPT, and compared outcomes to see if the PPT imposed a higher or lower standard than the Canadian GAAR.⁴³⁴ They concluded a “limited change from the status quo” in that the PPT as a “minimum standard introduced by the MLI is unlikely to change the analytic approach to tax treaty transactions in Canada from the previous GAAR approach”.⁴³⁵ They write that “[i]f the transaction or arrangement satisfies the GAAR’s object, spirit, and purpose test then in most cases the PPT will be satisfied as well”.⁴³⁶ Even with differences between them, “it is likely [the courts] will come to the same conclusion [using the PPT as] they would under GAAR”.⁴³⁷ “If the GAAR does not operate to deny a benefit because the benefit is in line with the object, spirit, and purpose of the provision then the same result is likely under the PPT”.⁴³⁸ Common standards between the EU’s *ATAD II*, GAAR and the PPT are such that “should one be satisfied the other surely is as well”.⁴³⁹

Given that the PPT operates and makes similar demands to some domestic GAARs, such that contravention of the PPT implies contravention of those domestic GAARs, choice of tax law and treaty law must necessarily comply with domestic anti-avoidance rules to comply with the PPT in certain legal contexts. Indirect choices of tax law, treaty law, and tax treaty benefits must comply with domestic anti-abuse rules, just as direct choice of law clauses in contracts must comply with the express and implied laws of the forum to meet the COL/col anti-abuse requirement of “legality”.

⁴³³ See art 6(1) of European Union, Council Directive 2016/1164/EU of 12 July 2016, *Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market*, OJ L 193/1, July 19, 2016, regarding hybrid mismatches at OJ L 144/1 (7.6.2017).

⁴³⁴ Catherine Anne Brown and Joseph Bogle, “Treaty Shopping and the New Multilateral Tax Agreement – Is it Business as Usual in Canada?” *Dalhousie Law Journal* (2020) 43:1 [Brown and Bogle, “Treaty Shopping and the *MLP*”].

⁴³⁵ Brown and Bogle, “Treaty Shopping and the *MLP*”, *ibid* at 28.

⁴³⁶ Brown and Bogle, “Treaty Shopping and the *MLP*”, *ibid* at 29.

⁴³⁷ Brown and Bogle, “Treaty Shopping and the *MLP*”, *ibid* at 29.

⁴³⁸ Brown and Bogle, “Treaty Shopping and the *MLP*”, *ibid* at 29.

⁴³⁹ Brown and Bogle, “Treaty Shopping and the *MLP*”, *ibid* at 30.

6.4.1.3 PPTs Showing “Public Policy” Requirement

Choices of law that form part of an arrangement to break the laws of another country are contrary to public policy and thus invalid.⁴⁴⁰ The PPT similarly forecloses choices of tax and treaty law which contravene the tax and treaty framework that exist between nations and are in force domestically, the reach of which is undermined through tax planning which seeks to access treaty provisions to obtain benefits the otherwise-applicable domestic law, which includes tax and treaty framework that exist between nations and are in force domestically, does not provide. ‘Laws of another country’ include the legal frameworks that exist between nations and are in force domestically.

The PPTs in the MLI and OECD 2017 Model Tax Treaty provide identically that “a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit”. Regarding characterizing a benefit in a covered tax agreement, Duff writes:

[T]he characterization of a benefit in the context of a specific arrangement or transaction necessarily depends on a standard or benchmark against which the existence of a “benefit” is measured. Since the PPT refers to a benefit “under the Covered Tax Agreement,” an obvious interpretation of this benchmark would be the tax consequences that would have resulted under the domestic law of a contracting jurisdiction absent the CTA.⁴⁴¹

Despite the potentially punitive consequences,⁴⁴² from a textual perspective, Duff concludes “it seems more reasonable to conclude that the existence of a benefit under a CTA should be determined by reference to the tax consequences that would have resulted under the domestic law of a contracting jurisdiction absent the CTA, not the tax consequences that would have resulted from an alternative arrangement or transaction that would otherwise have been carried out”.⁴⁴³ This interpretation drives to the tax and treaty framework that exists between nations and

⁴⁴⁰ Walker and Castel, *Conflict of Laws*, *supra* note 187, §31.6(b) “Obligation Invalidated by Public Policy” and §31.6(c) “Mandatory Rules of, and Illegality Under, Foreign Law”.

⁴⁴¹ Duff, “PPT Part 2”, *supra* note 306 at 969 citing *Cophorne Holdings Ltd v Canada*, 2011 SCC 63 at para 35, citing David G Duff, Benjamin Alarie, Kim Brooks, and Lisa C Philipps, *Canadian Income Tax Law*, 3d ed (Markham: LexisNexis, 2009) at 187.

⁴⁴²I.e., not account for the same benefit legitimately extended through other provisions or means: Duff, “PPT Part 2”, *ibid* at 970

⁴⁴³ Duff, “PPT Part 2”, *ibid* at 970 (emphasis added).

is in force domestically which would have applied but for the arrangement and access to the covered tax agreement.

According to Duff, “the tax consequences that would have resulted under the domestic law of a contracting jurisdiction absent the CTA” are informed by the law of contracting jurisdiction and the law of the third jurisdiction whose resident seeks to use the contracting jurisdiction as an intermediary. The domestic law that applies but for the treaty shopping is not only the domestic law of the contracting state, but forms a part of the tax and treaty landscape that otherwise binds the third-country entity and that they must themselves comply with. Absent a valid choice of law, the third country resident is bound by the tax and treaty law of their “proper law” jurisdiction, and that includes the tax relationship negotiated or otherwise with the contracting state whose tax treaty the third country entity now seeks to take advantage of. By setting ‘but for’ benchmarks, the PPT implicitly acknowledges the surrounding legal context that one country’s tax law includes its arrangements with other states, and that attempts to go outside the bounds of that is a breach of a foreign legal rule most closely connected to the arrangement. Courts in COL/col anti-abuse cases consider the insertion of their law to avoid legal obligations in another jurisdiction closely connected with the arrangement to be contrary to public policy.⁴⁴⁴

6.5 Concluding on Anti-Treaty Shopping Rules

While the OECD acknowledges contracting states may employ a “certain degree of flexibility” in adopting the revised preamble, LOB provision, and PPT to account for local characteristics, i.e., where contracting states already have domestic anti-abuse or anti-avoidance rules rendering general anti-abuse provisions in the treaty redundant, or where contracting states have administrative resource limitations rendering detailed LOB provisions too challenging to enforce,⁴⁴⁵ states must nonetheless “effectively address... treaty abuses along the lines of [the OECD 2015 Action 6] report.”⁴⁴⁶ The OECD’s concern about “treaty shopping” shows its implicit appreciation of the significance of choice of law selection in the international tax and BEPS environment.⁴⁴⁷ Underlying each of these three anti-treaty shopping features in the MLI,

⁴⁴⁴ See e.g., *Regazzoni*, *supra* note 269.

⁴⁴⁵ OECD 2015 Action 6 Report, *supra* note 301 at paras 6 and 21.

⁴⁴⁶ OECD 2015 Action 6 Report, *ibid* at paras 6 and 22.

⁴⁴⁷ Implicitly employed as it is in the international tax environment, the COL/col anti-abuse approach queries if there is a forum relevance for the insertion of a jurisdiction’s law and legal system in the chain of events, such that a different outcome is justified. This is the essence of OECD 2017 Model Tax Treaty, *supra* note 23, arts 8 to 10

OECD 2017 Model Tax Treaty, and Canada-USA Tax Treaty (in the case of the LOB) are the implicit notion that multinational corporations' choice of private law, tax law, and therefore tax treaties and benefits flowing therefrom, should be limited to choices of tax law that are *bona fide*, legal, and compliant with public policy. Lord Wright's affirmation in *Vita Food* that a choice of law must be *bona fide* and legal, and not contrary to public policy cuts to the core of the BEPS Action 6 pursuit against "treaty shopping" by ensuring that treaty benefits only flow in certain circumstances, that taxpayers do not slip from the tax net of jurisdictions who wield a lawful claim, and that countries are not compelled to extend hard-negotiated benefits to persons not intended to benefit from them.

concerning transfer pricing, BEPS Action 5 regarding preferred tax regimes, BEPS Action 6 concerning treaty abuse. All interrogate the significance of a third jurisdiction with no connections.

7 Conflict of Laws “Choice of Law” to Find Governing Law

The question of ‘what is the nature of the transaction, person, income, etc.?’ sits at the heart of international conflicts of tax law. The first essential step to answering it is determining the governing law to be used as a keystone. Supranational approaches, such as the OECD’s harmonization proposals, and bilateral approaches of reconciliation, such as COL/col principles latent in tax treaties, alike each propose a way to ascertain the governing law through which to answer the question. While both answer the question well, only the latter does so while also supporting states’ sovereign power to enact and enforce tax laws that align most closely with its domestic community.

The foregoing discussion simplifies and focuses the pursuit of ascertaining the governing law in archetypal conflict of tax laws by showing how governing law is ascertained in tax treaties through a latent COL/col approach that reconciles countries’ legitimate, concurrent, and simultaneous tax claims while supporting state sovereignty. Not only do tax treaties’ implicit COL/col approach already do what supranational harmonization proposals endeavour to do, but do so in support of state sovereignty.

In tax treaties, governing law is ascertained by many of the same legal principles as in COL/col. COL/col principles acknowledge the inevitable encounter of countries’ legal systems, anticipate diverse legal regimes, and support countries’ law-making sovereignty by permitting both legal systems to remain intact, unchanged, and unharmonized even though one of the contending legal systems prevails over the other contenders and applies in the circumstances as the governing law. Because COL/col does these things, tax treaties in which they are implicit can and do so as well.

Schiff Berman writes that “[t]he rise of global legal pluralism has brought renewed focus to the core principles of conflict of laws (sometimes called private international law): jurisdiction, choice of law, and recognition of judgments. In a world of multiple legal and quasi-legal pronouncements, these doctrines become a core way of navigating the interactions, using principles that derive from both legal formalism and political practicality”.⁴⁴⁸ Such renewed focus can be detected in the articles in tax treaties providing foreign tax recognition, distributive

⁴⁴⁸ Schiff Berman, “Legal Pluralism”, *supra* note 37 at 160-161

rules, meanings for undefined terms, and anti-treaty shopping rules tax treaties in which COL/col principles are latent.

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