

TAX COURT OF CANADA

B E T W E E N :

PREVOST CAR INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

WRITTEN ARGUMENT OF THE APPELLANT

A. FACTS

Introduction

1. The facts of this case are not complicated. In 1995, Volvo Bussar AB (“Volvo”) and Henlys Group plc (“Henlys”) acquired shares in the Appellant, Prevost Car Inc., through a subsidiary, Prevost Holdings B.V. (“B.V.”), a company resident in the Netherlands.

2. In the period from 1996 to 2001, the Appellant paid dividends to B.V. and withheld tax at the applicable rate of five percent. The Canada Revenue Agency (“CRA”) takes the position that B.V. was not the “beneficial owner” of the dividends it received and seeks to impose tax at a rate of 15 percent on dividends the CRA attributes to Volvo and 10 percent on dividends it attributes to Henlys.
3. These appeals turn entirely on the issue of whether B.V. was the “beneficial owner” of the dividends paid by the Appellant.
4. It is the Appellant’s position, for the reasons that follow, that B.V. was in fact and law the beneficial owner of the dividends paid by the Appellant. In this submission, we will briefly discuss the evidence adduced at the hearing and then the authorities on this issue.

Evidence of Tore Backstrom

5. Volvo is a world leader in the production of chassis for buses and motor coaches. It has offices and facilities in Sweden and throughout the world either directly or through subsidiaries. Henlys was a leading manufacturer of coach and bus bodies. Its primary offices and facilities were located in the United Kingdom.
6. Beginning in the mid-1980s, Volvo and Henlys began working together in the manufacturing of buses and motor coaches and, by 1994, had agreed to work as co-venturers in certain markets. North America was identified as the key target market.
7. In 1995, Volvo and Henlys agreed to acquire the Appellant (which was already an established coach manufacturer in Canada) as the first step in a growing and substantial manufacturing co-venture in North America. However, Henlys had difficulty raising the

necessary funds to satisfy the purchase price for its 49 percent interest in the Appellant. To accommodate Henlys' cash flow difficulties, it was agreed that Volvo would purchase all of the Appellant's shares, which Volvo would then transfer to a holding company (B.V.). Upon receipt of sufficient funding, Henlys would then purchase 49 percent of the shares of B.V. from Volvo.

8. Volvo and Henlys agreed that B.V. would be established in the Netherlands to facilitate the acquisition of the Appellant and other potential acquisitions in the North American and international markets. Companies engaged in co-venture arrangements routinely create companies to hold assets such as target companies. The acquisition and holding of the shares of the Appellant by B.V. followed this well-established merger and acquisition practice.
9. In this respect, the Netherlands offered an English-speaking, highly-developed legal, commercial and banking infrastructure that was conducive to international joint venture operations. Moreover, the Netherlands was considered a "neutral" country that would minimize any potential biases in the business relations between Volvo and Henlys that might have arisen had the holding company instead been incorporated in either Sweden or the United Kingdom.
10. In addition to acquiring the Appellant, Volvo and Henlys explored other joint venture business opportunities in North America, Eastern Europe and the Far East. For example, an opportunity arose for Volvo and Henlys to jointly acquire a Mexican coach manufacturer, Masa. Unfortunately, Henlys was unable to raise the necessary funds to invest in Masa, leaving Volvo to pursue this opportunity independently. Had Henlys

participated in this venture, the shares of Masa would have been held by B.V., just as the shares of the Appellant were held.

11. Once B.V. had acquired the shares of the Appellant, in order to facilitate the operation of B.V. a limited grant of authority was given to Trust International Management (T.I.M.), a professional Dutch trust company, which had responsibility for the administrative functions of B.V. At all times, T.I.M. conducted itself within its limited authority.
12. Volvo and Henlys entered a shareholders agreement pursuant to which not less than 80 percent of the profits of the corporate group (the Appellant and B.V.) should be distributed to the shareholders. Such distributions were subject to, among other things, the group having sufficient financial resources available to meet its investment and working capital requirements.
13. The Appellant distributed a portion of its earnings to B.V. as dividends, and B.V. subsequently paid similar amounts as dividends to its shareholders, Volvo and Henlys. The shareholders' resolution and dividend policy adopted by the Appellant and B.V. reflected normal and prudent cash-flow and treasury management practices of large multinational corporate groups.
14. All dividends paid by B.V. were validly declared by its board of directors. Although resolutions may not have been signed contemporaneously with the payment of the dividends in all cases, there was nothing unusual from a corporate perspective in formalizing certain board decisions in writing after the fact.

Evidence of Cindy Kalb

15. There is no dispute that B.V. was resident in the Netherlands during the Taxation Years for purposes of the Treaty.¹
16. The Crown has acknowledged that B.V. was the legal owner of the shares of the Appellant.²
17. The Crown has acknowledged that B.V. was the legal owner of the dividends paid to it on the Appellant's shares.³
18. The Crown has acknowledged that all dividends paid by the Appellant to B.V. were properly declared and paid.⁴
19. The Crown further acknowledged that the dividends received by B.V. were within the taxing authority of the Netherlands and that, but for the participation exemption granted under Dutch tax law B.V. would have been subject to Dutch tax in respect of the dividends.⁵

¹ See, for example, Examination for Discovery of Cindy Kalb, at pages 35-36, Q. 142-146.

² See, for example, Examination for Discovery of Cindy Kalb, at page 35, Q. 142; pages 106-108, Q. 424-430; pages 126-127, Q. 512-518; and pages 114-115, Q. 458-460.

³ See, for example, Examination for Discovery of Cindy Kalb, at page 35, Q. 142; pages 106-108, Q. 424-430; pages 126-127, Q. 512-518; and pages 114-115, Q. 458-460.

⁴ See, for example, Examination for Discovery of Cindy Kalb, at pages 113-114, Q. 456; and pages 239-247, Q. 990-1015.

⁵ See, for example, Examination for Discovery of Cindy Kalb, at pages 109-111, Q. 437-444.

20. Moreover, the CRA has indicated that the fact that B.V.’s operations were carried out by a third-party management company *did not have any impact* on the decision to reassess the Appellant in respect of the dividends.⁶
21. With respect to B.V.’s banking documentation, there is no dispute that such documentation referred to Volvo and Henlys as the “beneficial owners” of B.V.’s bank account for purposes of satisfying to the Dutch bank’s “know-your-client” (“KYC”) policies.⁷
22. These KYC policies concerned anti-money laundering and bank regulatory issues, which were intended to satisfy the bank’s requirements to know who was ultimately “behind the funds” in the account.⁸
23. With respect to the shareholders’ agreement governing distributions from B.V. to its shareholders, the Crown has not disputed the validity of this agreement under Dutch law.⁹
24. Similarly, the fact that this agreement was initially entered into by Volvo and Henlys prior to the incorporation of B.V. was not considered relevant by the CRA in reassessing the Appellant in respect of the dividends.¹⁰

⁶ See, for example, Examination for Discovery of Cindy Kalb, at pages 162-164, Q. 658-663.

⁷ Additionally, the Appellant notes that all banking documents relating to the statement of purpose and statement of source of funds (referred to in the banking documents as “beneficial ownership”) are signed by T.I.M. See Joint Book of Documents, at tabs 27, 61, 62, and 139.

⁸ See, for example, Examination for Discovery of Cindy Kalb, at page 142, Q. 582-584; pages 191-193, Q. 777-783; and pages 213-216, Q. 866-878.

⁹ See, for example, Examination for Discovery of Cindy Kalb, at pages 126-128, Q. 512-524.

¹⁰ See, for example, Examination for Discovery of Cindy Kalb, at page 244, Q. 1004-1006.

25. In assessing the Appellant, the Minister focused on the fact that B.V.’s shareholders were the “ultimate” recipients of the dividends, not the “beneficial owners.”¹¹
26. The Crown has further acknowledged that the general anti-avoidance rule (“GAAR”) formed part of the decision to reassess and formed part of the confirmation of the reassessments, but was abandoned by the Crown in its pleadings.¹²
27. Upon further audit of the dividends and verification of the reassessments in respect thereof, the CRA did not invoke a principle of “transparency” or “look-through” and did not consider B.V. to be an agent for Volvo or Henlys in receiving the dividends.¹³

Evidence of Daniel Luthi

28. A report was submitted to the Court by Daniel Luthi, an expert in OECD international tax and treaty matters and a member of the OECD Working Party No. 1 on Tax Conventions and Related Questions, the committee responsible for drafting the OECD Model Tax Convention and Commentary. Mr. Luthi made the following points about the concept of beneficial ownership, as used in the OECD Model Tax Convention:
- (a) The aim of including the term “beneficial owner” was to prevent treaty shopping by attempting to exclude intermediaries like agents and nominees from treaty benefits;

¹¹ See, for example, Examination for Discovery of Cindy Kalb, at page 155, Q.628; page 168, Q.677.

¹² See, for example, Examination for Discovery of Cindy Kalb, at pages 227-228, Q. 928-937.

¹³ See, for example, Examination for Discovery of Cindy Kalb, at pages 204-205, Q.837-840.

- (b) Under Article 10 of the OECD Model Convention, other persons are entitled to tax relief provided they are residents of the other Contracting State and not acting as an agent or nominee;
- (c) A holding company should be considered the beneficial owner of dividends unless there is a strong indication of tax avoidance and/or treaty abuse;
- (d) A holding company cannot, per se, be considered an intermediary or agent. This is especially the case where mainly non-tax reasons were decisive for interposing the company and establishing it in a given country; and
- (e) Modifications made after the 1977 OECD Commentary have not changed this concept of beneficial ownership.

Evidence of Stef van Weeghel

29. A report was submitted to the Court by Professor Stef van Weeghel, an expert in Dutch and international tax law. In the report, Professor van Weeghel stated the following:
- (a) A person is not the beneficial owner of a dividend where the recipient is under a contractual obligation to pay the largest part of the dividend income to third parties;
 - (b) Dutch case law establishes that a person is a beneficial owner of a dividend coupon where:
 - (i) He or she owns the dividend coupon;
 - (ii) He or she can freely avail of the coupon; and

- (iii) He or she can freely avail of the monies distributed;
- (c) Under Dutch law and under general principles of international tax law there is a presumption that a subsidiary is the beneficial owner of its assets. This is to ensure certainty for both taxpayers and tax authorities;
- (d) Under Dutch law, B.V. is regarded as the beneficial owner of the dividends;
- (e) The position advanced by the CRA is not supported by the Government of the Netherlands; and
- (f) Under Dutch law, the payment of dividends to B.V. is not considered an abuse of the Convention.

Evidence of Rogier Raas

30. A report prepared by Dr. Rogier Raas, an expert in Dutch commercial law, was submitted to the Court. In the report, Dr. Raas stated the following:
- (a) Despite the existence of a shareholders' agreement between Volvo and Henlys and the powers of attorney granted to T.I.M., B.V. itself was not contractually or otherwise required to pass on the dividends it received from the Appellant. In all cases, dividend payments had to be authorized by B.V.'s directors in accordance with Dutch law and practice;
 - (b) The shareholders' agreement and powers of attorney did not have any effect on the ownership of the dividends by B.V.; and

(c) Accordingly, B.V. never acted as an agent, nominee or conduit for Volvo and Henlys. As such, B.V. must be considered the beneficial owner of the dividends for the purpose of the Convention.

Evidence of Sharon Gulliver

31. At the time B.V. acquired the shares of the Appellant, Canada had announced its intention to lower the dividend withholding rate to five percent in all of its income tax treaties. This intention was public knowledge at that time and the CRA has so acknowledged.¹⁴
32. Moreover, the CRA Legislative and Policy Directorate had informed Sharon Gulliver of the Aggressive Tax Planning Division that, in its view, “for a court to consider treaty shopping offensive under current law we think you may need more than temporary arbitrage rates between treaty partners.”¹⁵
33. The CRA Legislative and Policy Directorate also indicated that “it will be difficult for a court to smell the nastiness of this scheme by two multinationals resident in treaty countries, to avail themselves of the [5 percent] policy rate.”¹⁶
34. The CRA Legislative and Policy Directorate has acknowledged that it discussed this case with the Department of Finance, “which indicated that they did not find this treaty

¹⁴ See, for example, email of Ross Kauffman to Sharon Gulliver, dated July 5, 2004 at 3:32 p.m.

¹⁵ See, for example, email of Ross Kauffman to Sharon Gulliver, dated July 7, 2004 at 9:30 a.m.

¹⁶ See, for example, email of Ross Kauffman to Sharon Gulliver, dated July 5, 2004 at 5:08 p.m.

shopping particularly offensive *vis a vis* residents in a non-treaty country availing themselves of lower rates.”¹⁷

35. Additionally, the CRA Legislative and Policy Directorate had informed the CRA Aggressive Tax Planning Division of its concern in the present case that the Crown may be unable to convince a court that the Dividends were effectively paid directly by the Appellant to Volvo and Henlys.
36. Moreover, the CRA Legislative and Policy Directorate had advised the CRA Aggressive Tax Planning Division that establishing B.V. was not the beneficial owner of the Dividends in this case would be an “uphill battle made even more difficult in the context of the alleged mischief.”¹⁸
37. Furthermore, the CRA Legislative and Policy Directorate had informed the CRA Aggressive Tax Planning Division that the lack of “technical LOB [Limitation on Benefits] provisions” in a treaty significantly hampers the ability of the CRA in preventing “treaty shopping.”¹⁹

¹⁷ See, for example, email of Ross Kauffman to Sharon Gulliver, dated July 7, 2004 at 9:30 a.m.

¹⁸ See, for example, email of Ross Kauffman to Sharon Gulliver, dated July 7, 2004 at 9:30 a.m.

¹⁹ See, for example, email of Ross Kauffman to Sharon Gulliver, dated July 7, 2004 at 9:30 a.m.

B. LEGISLATIVE AND TREATY FRAMEWORK

Background of the Canadian Dividend Withholding Tax Regime

38. Subsection 212(2) of the *Income Tax Act (Canada)*²⁰ levies a 25 percent withholding tax on any non-resident shareholder who receives a taxable dividend from a Canadian corporation.
39. Canada has entered into numerous income tax treaties with various countries. Among other things, the treaties reduce the withholding rate on dividends from 25 percent to a lower rate, usually five percent, 10 percent or 15 percent.
40. Canada officially announced in the 1992 Federal Budget, that it would seek to include a five percent withholding tax rate in all of its tax treaties negotiated or renegotiated after December 31, 1992 in respect of dividends paid to shareholders having a substantial interest in the company.²¹ This policy did not stem from altruism or philanthropy; rather, Canada's objective was to reduce the rate of foreign taxation of Canadian business profits.
41. In this respect, the dividend withholding tax rate under the Canada/Sweden Treaty was reduced from 10 percent to five percent commencing on January 1, 1998. Similarly, the dividend withholding tax rate under the Canada/U.K. Treaty was reduced from 15 percent to five percent effective January 1, 2005.

²⁰ R.S.C. 1985, c. 1, 5th Supp. (as amended) [the "Act"].

²¹ Federal Budget, released February 25, 1992, Canadian Tax Reports, Special Report No. 9711, at p. 22-23.

Background of the Treaty and the Use of the Term “Beneficial Owner”

42. The Canada/Netherlands tax treaty was signed on May 27, 1986.²² The *Treaty* was based on the 1977 model income tax convention developed by the *Organisation for Economic Cooperation and Development* (“OECD”) and the Commentary thereon.²³
43. During the taxation years under appeal, Article 10(2) of the *Treaty* provided a reduction in the Canadian dividend withholding tax rate from 25 percent to five percent²⁴ in respect of dividends paid by a Canadian corporation to a corporation resident in the Netherlands if:
- (a) the dividend recipient owned at least 25 percent of the capital or at least 10 percent of the voting power in the Canadian corporation; and
 - (b) the dividend recipient was the “beneficial owner” of the dividends.
44. The Respondent has conceded that the requirement in paragraph (a), above, was satisfied.
45. The term “beneficial owner” is not defined in the *Treaty*.
46. The *Treaty* replaced the 1957 tax treaty between Canada and the Netherlands,²⁵ which had provided a zero rate (0%) of dividend withholding tax in certain circumstances.

²² *Convention Between Canada and the Kingdom of the Netherlands For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income*, S.C. 1986, c.48, Part I [the “*Treaty*”].

²³ Department of Finance (Canada) Press Releases No. 86-103, May 27, 1986; No. 84-115, dated July 19, 1984; Dutch Ministry of Finance Press Release 97/166, May 27, 1986; and Dutch Explanatory Note to the Convention of 27 May 1986, Introduction, 1985-1986, 19 957, no.1.

²⁴ Six percent in respect of dividends paid prior to 1997.

²⁵ *Convention between the Government of Canada and the Government of the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income*, signed at Ottawa

Fundamental Principles of Tax Treaty Interpretation

47. It is well-established law that treaties must be interpreted by the contracting states in good faith based on the intention of the parties when drafting the treaty.
48. In this respect, the parties are presumed to have the intention which appears from the ordinary meaning of the terms used by them in the treaty. The ordinary meaning of a treaty term is not to be determined in the abstract but in the context of the treaty and in light of its object and purpose.²⁶
49. In determining the true intention of contracting states, Canadian courts have held that a treaty must be given a liberal interpretation. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated.²⁷
50. Canadian courts have held that Canada is expected to conform to the OECD Model in negotiating and interpreting its bilateral tax treaties.²⁸

on 2 April 1957, as modified by the *Supplementary Convention* signed at Ottawa on 28 October 1959 and as further modified by the *Supplementary Convention* signed at Ottawa on 3 February 1965.

²⁶ *The Vienna Convention on the Law of Treaties*, UN Doc. A/Conf. 39/27, signed at Vienna on May 23, 1969 (“VCLT”), Articles 31 and 32. See also paragraph 12 of the *United Nations Commentaries (Travaux Préparatoires)* to Article 31, UN Doc. A/CONF. 39/Add. 2, 7 at 37. See also *Crown Forest Industries Ltd. v. R.*, 95 DTC 5389 (S.C.C.) [*Crown Forest*] at para. 29.

²⁷ *The Queen v. St. John Shipbuilding & Dry Dock Co. Ltd.*, 80 DTC 6277 (Fed. C.A.) at para. 13; *Gladden Estate v. The Queen*, [1985] 1 CTC 163, at 166-67 (F.C.T.D.) at para. 14; approved in *Crown Forest*, *supra*.

²⁸ Paragraphs 27 and 28 of the *Introduction to the Model* (1977 OECD Model Treaty and Commentary); *Cudd Pressure Control Inc. v. The Queen*, 98 DTC 6630 (Fed. C.A.) [*Cudd Pressure*] at para. 41; *Crown Forest*, *supra*; *Sutcliffe v. Her Majesty the Queen*, 2006 DTC 2076 (T.C.C.), additional reasons at 2007 DTC 6 (under appeal). OECD rules require that concerns about the text of the Model Treaty must be included as Reservations and concerns about the text of the Commentary must be included as Observations. While Canada has a number of Reservations and Observations about the Model Treaty and Commentary, there are none about Article 10 concerning Dividends.

C. ARGUMENT

Two Potential Sources for the Meaning of “Beneficial Owner”

51. There are two equally plausible meanings of the term “beneficial owner” for purposes of Article 10, paragraph 2 of the *Treaty*:²⁹
- (a) a meaning for the purpose of the domestic law of the contracting state seeking to apply the *Treaty* (in the present case, the meaning for the purpose of the *Act*); and
 - (b) a specific treaty-based “international” meaning.
52. Both meanings support the Appellant’s position that B.V. was the beneficial owner of the dividends and, accordingly, was entitled to the reduced rate of withholding under Article 10, paragraph 2 of the *Treaty*.
53. Pursuant to the *Treaty*, undefined *Treaty* terms such as “beneficial owner” are to have the meaning under the domestic law of the contracting state seeking to apply the *Treaty*, unless the context otherwise requires.³⁰

²⁹ See, for example, Michael N. Kandev, “Tax Treaty Interpretation: Determining Domestic Meaning under Article 3(2) of the OECD Model” (2007) 55: 1 *Canadian Tax Journal* 31 at 69: “For instance, with respect to the undefined treaty expression “beneficial owner,” it is arguable that this term should be given a tax-treaty meaning that is independent of the tax law of a particular state. However, there does not seem to be any agreement on what meaning should be used instead. One option is that the domestic-law meaning of “beneficial owner” in common-law countries be imported into the OECD model as a universal meaning. Another option is that “beneficial owner” be given an independent meaning that is consistent with the OECD’s views on the subject. Recent cases have grappled with the issue show the divergence in opinion.” [footnotes omitted]

³⁰ Article 3 paragraph 2 of the *Treaty*.

54. Moreover, pursuant to Canadian law, undefined treaty terms are to be given the meaning that the term has under the *Act* at that point in time, unless the context otherwise requires.³¹

Meaning of “Beneficial Owner” for Purposes of the Income Tax Act (Canada)

55. In *R.A. Jodrey Estate v. Minister of Finance (Nova Scotia)*³² the Supreme Court of Canada adopted this definition of “beneficial owner”:

It seems to me that the plain ordinary meaning of the expression “beneficial owner” is the real or true owner of the property. The property may be registered in another name or held in trust for the real owner, but the “beneficial owner” is the one who can ultimately exercise the rights of ownership in the property.³³

56. The Supreme Court also distinguished between “beneficial owner” and “beneficially entitled”:

I believe that the other expression “beneficially entitled to” has a slightly different meaning from that of “beneficial owner”. The person beneficially entitled to property may be further removed from the exercise of ultimate ownership of the property than the “beneficial owner”, but as long as that person has the right to

³¹ *Income Tax Conventions Interpretation Act*, R.S.C. 1985, c. I-4, as amended, section 3.

³² 81 DTC 5344 (S.C.C.).

³³ *Ibid.* at para. 47.

legally establish the exercise of the rights of ownership over the property then it may be said that he is beneficially entitled thereto.³⁴

57. The Supreme Court also noted, from a different case, that, “ ... according to the legal meaning of the words, a company is not the beneficial owner of the assets of its own subsidiary.”³⁵
58. Importantly, in *Jodrey*, the Supreme Court did not intend the word “ultimately” to mean “in the long run” or “at the end of a series of events,” but the Court did intend it to mean “at law” or “after looking through the trust agreement.” This is indicated by the Court’s distinction between “beneficially owned” and “beneficially entitled.”³⁶
59. If Canada intended “beneficial owner” in the *Treaty* to mean “beneficially entitled”, presumably it would have said so, as it did in the Canadian treaty with Australia.³⁷ In

³⁴ *Ibid.*, at para. 20.

³⁵ Citing *Rodwell Securities Ltd. v. IRC*, [1968] All E.R. 257 at 260.

³⁶ See also *Griffin v. Charles M. Stewart Inc.*, [1986] P.E.I.J. No. 34; 58 Nfld. & P.E.I.R. 62; 22 E.T.R. 275; 37 A.C.W.S. (2d) 374 (S.C.) where the court says:

In the words of the statute, he holds as trustee “for the persons by law beneficially entitled thereto.” Those words are of significance. He is “beneficially entitled” if he is in a position, ultimately, to exercise the rights of ownership over the property of the deceased, and where he could legally recover the property for his own benefit. See: *MacKeen Estate v. Nova Scotia*, 25 N.S.R. (2d) 572 at p. 598. In that case, the learned trial judge, Hart, J., notes the distinction to be drawn between a person being the beneficial owner, and a person being beneficially entitled. The person beneficially entitled to property, he observes, may be further removed from the exercise of ultimate ownership of the property than the beneficial owner, but as long as that person has the right to establish, legally, the exercise of the rights of ownership over the property, then it may be said he is beneficially entitled thereto.

He who is beneficially entitled to any property does not have, as I perceive it, an estate in that property, as would have a beneficial owner, whether in possession or not. He has but the right to require that the estate in the property, now vested in another as trustee, be transferred to, and be vested in, him. Until that prerogative is exercised, all he has is a chose in action. On the other hand, he who is the beneficial owner has, in fact, a current estate in the property. He has, in the terms of *Rodwell Securities, Ltd. v. Inland Revenue Commissioners*, [1968] 1 All E.R. 257, complete control over the disposition of the property.

³⁷ *Convention Between Canada and Australia For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, Article 10(2), S.C. 1980-81-82-83, c. 56 Part II.

fact, at the time the *Treaty* was being considered, the Canadian government specifically noted in Parliamentary debate that the *Treaty* was “substantially the same” as those which Canada had entered into before and that there were “no new or unusual features” in the *Treaty*.³⁸

60. “Beneficial owner” under Canadian domestic law is an equitable concept; it does not have a colloquial meaning as the person who will ultimately receive the benefit of the funds, as does the phrase “beneficially entitled”. The two concepts are not the same and should not be equated. But that is exactly what the Minister did in assessing the Appellant.³⁹
61. The position taken by the Respondent in this appeal conflicts with the CRA’s own published administrative position that it will treat the registered owner of shares as the beneficial owner of dividends paid thereon unless there is reason to believe that the registered owner holds the shares as an agent or nominee (even if the registered owner was under a contractual obligation to make an onward distribution of the dividend).⁴⁰

³⁸ House of Commons Debates, 1st Session, 27th Parliament, 1966, Vol. III, p. 3085; Vol. IV, p. 339-4346, Vol. V, p. 4504, 5061; Vol. XII, p. 12823; Vol. XIII, p. 13537-43544, 13641; House of Commons Debates, 2nd Session, 33rd Parl., 1986, Vol. 1, p. 1155, 1208; Vol. II, 1986-1987, p. 1571-1573, 1617; Senate Debates, 1966 – 1967, Vol. II, p. 1550, 1569-77, 1418-1419, 1424, 1541; Senate Debates, 1986-1988, p. 61, 81-82, 100-101, 186-187, 262, 278.

³⁹ See, for example, Examination for Discovery of Cindy Kalb, page 155, Q. 628; page 168, Q.677.

⁴⁰ CRA Views 7-3743 “Non-resident tax implications of share lending transaction” (14 June 1989). See also CRA, Information Circular IC 76-12R5, “Applicable rate of Part XIII tax on amounts paid or credited to persons in countries with which Canada has a tax convention” (31 December 2000).

International Meaning of “Beneficial Owner”

62. As stated above, the meaning of “beneficial owner” for purposes of Article 10(2) of the *Treaty* is to be derived from the *Act*, unless the context otherwise requires.⁴¹
63. Canadian courts have indicated that the OECD Commentary is to be considered part of the legal context of tax treaties based on an OECD Model and is to be considered of “highly persuasive value” in determining the intent of the contracting states.⁴²
64. In considering the meaning of “beneficial owner”, it is necessary to consider the historical development of that phrase in bilateral tax treaties. Since 1961 a number of countries around the world, including Canada and the Netherlands, have been members of the OECD.⁴³ The OECD’s first model tax treaty was published in draft form in 1963.⁴⁴ The 1963 Draft OECD Model did not use the term “beneficial owner” in the context of dividend withholding tax, but rather extended treaty benefits to any dividend recipient who was merely resident in the other contracting state.⁴⁵

⁴¹ See, for example, Ronald K. Durand and Leela A. Hemmings, *Beneficial Ownership Under Canada’s Treaties*, May 8, 2006, International Fiscal Association, Canadian Branch. See also Kandeve, *supra*.

⁴² *Hinkley v. M.N.R.*, 91 DTC 1336 (T.C.C.); *Crown Forest*, *supra*, at para. 55; *RMM Canadian Enterprises Inc. v. R.*, 97 DTC 302 (T.C.C.); *Speciality Manufacturing Ltd. v. R.*, 97 DTC 1511 (T.C.C.); *Cudd Pressure*, *supra*, at para. 28; *Edwards v. R.*, 2002 DTC 1856 (T.C.C.).

⁴³ The OECD was formed in 1961 as an international body to assist in, among other things, developing strategies to support sustainable international economic growth and financial stability. One of the OECD’s continuing projects has been to develop and refine a model tax convention intended to be used by member states in negotiating bilateral tax conventions. There are currently 30 member states of the OECD. Canada was a founding member, being a signatory to the OECD’s founding convention on December 14, 1960. See www.oecd.org.

⁴⁴ *Organisation for Economic Co-operation and Development, Draft Double Taxation Convention on Income and Capital* (Paris: OECD, 1963) [the “1963 Draft OECD Model”].

⁴⁵ *Ibid.* at Article 10(2).

65. The use of the term “beneficial owner” in respect of dividend withholding tax was first proposed by the OECD in draft form in 1974 and was thereafter formally adopted by the OECD in its 1977 model income tax convention⁴⁶ and the Commentary thereon.
66. The importance of the 1977 OECD Model is illustrated by the fact that Canada now uses the term “beneficial owner” in the dividend article of 85 of its 86 income tax conventions.⁴⁷
67. The OECD Commentary to Article 10(2) of the 1977 Model Treaty explains that the term “beneficial owner” was used to ensure that “agents and nominees” did not receive the benefit of the reduced withholding rate. An example of a typical agent or nominee would be a stockbroker or clearing and depository services provider, either of which would merely receive a dividend on behalf of the true owner of the share on which the dividend was paid, but would have no independent entitlement over the funds.⁴⁸
68. There is no evidence to suggest that either Canada or the Netherlands disagreed with the OECD’s suggested interpretation of “beneficial owner”, as reflected in the 1977 OECD Model and Commentary in existence at the time the Treaty was signed. Notably, neither Canada or the Netherlands entered any reservations or observations in respect of the

⁴⁶ *Organisation for Economic Co-operation and Development, Model Tax Convention on Income and on Capital* (Paris: OECD, 1977) [the “1977 Model Treaty”]

⁴⁷ The convention with Australia uses the term “beneficially entitled”. See the chart at tab 1 in Exhibit A-1.

⁴⁸ Paragraph 12 of the 1977 Commentary to Article 10 of the 1977 Model Treaty; Expert report of Daniel Lüthi, dated February 24, 2006, Answer to Question #1.

OECD's interpretation of "beneficial owner" as contained in the 1977 OECD Model Convention and the Commentary thereon.⁴⁹

69. As early as 1986 a report of the OECD made it clear that "conduit companies" (i.e. holding companies established primarily to hold investments and distribute investment income to shareholders) are *prima facie* considered the beneficial owners of income derived from their investments. Only if the conduit has very limited powers that render it a mere "fiduciary" or "administrator" with respect to the dividend income should such companies not be considered the "beneficial owner" of the dividend.⁵⁰
70. In this respect, a holding company that serves its ordinary purpose and is appropriately managed by a board of directors should be considered the "beneficial owner" of dividends received for treaty purposes on the basis that it is acting on its own behalf and not in a representative capacity.⁵¹
71. Contracting states are required to act in accordance with their obligations under bilateral tax treaties. In determining whether a contracting state is, in fact, acting contrary to its treaty obligations, it is relevant to learn how the domestic law of the other contracting

⁴⁹ Canada noted several observations and reservations to the 1977 OECD Model, but did not do so in respect of the meaning of "beneficial owner". In fact, Canada reserved its position with respect to Article 10, subparagraphs 2(a) and (b) of the 1977 OECD Model, dealing with the amount by which the dividend withholding tax rates would be reduced, but did not register any observation with respect to the meaning of "beneficial owner". Accordingly, at the time the 1977 OECD Model was drafted and at the time the Treaty was signed, Canada clearly understood its ability to deviate from the interpretations and recommendations contained in the 1977 OECD Model and Commentary upon which the Treaty was based.

⁵⁰ "Double Taxation Conventions and the Use of Conduit Companies," adopted by the OECD Council on November 27, 1986 [*1986 Conduit Report*].

⁵¹ *Wood and Another v. Holden (Inspector of Taxes)*, [2006] EWCA Civ 26 (C.A.) [*Wood*] at paras. 25, 41 and 42; Expert report of Daniel Lüthi, dated February 24, 2006, Answer to Question 2.

state would regard the position being asserted by the first-mentioned contracting state.⁵² The Dutch government has suggested, and experts in the field of Dutch law and treaty interpretation have clearly indicated, that they reject the position advanced by the Crown in this case and instead consider B.V. to be the beneficial owner of the Dividends for purposes of Article 10, paragraph 2 of the *Treaty*.⁵³

Relevance of International Case Law

72. There are very few instances where foreign courts have refused to allow treaty protection to dividends based on Article 10 of the Model Treaty. For the most part, the few international cases that address the denial of reduced withholding tax rates have involved back-to-back interest payments and not the onward payment of dividends. In one case, a Swiss court disallowed the protection by applying an inherent anti-abuse doctrine.⁵⁴ In the other, a French court found that a structure involving the transfer of dividends to a bank was in substance a loan and the beneficial owner of the dividends was the borrower, not the bank.⁵⁵

⁵² Commentary to the *Model Double Taxation Convention on Income and Capital*: Organisation for Economic Co-operation and Development, April 11, 1977, Article 3, paragraph 12 (this portion of the Commentary was introduced in 1992 with subsequent modification in 1995); *Black-Clawson Ltd. v. Papierwerke AG*, [1975] AC 591, at 640 (HL); *Hunter Douglas Ltd. v. The Queen*, 79 DTC 5340 (F.C.T.D.).

⁵³ See, for example, Joint Book of Documents, tabs 80 and 82; Expert report of Stef van Weeghel, dated June 14, 2006; Expert report of Daniel Lüthi, dated February 24, 2006; Expert reports of Rogier Raas, dated June 13, 2006 and November 9, 2006.

⁵⁴ *A Holding ApS v. Federal Tax Administration*, 8 ITLR 536 (Swiss FC – November 28, 2005).

⁵⁵ Conseil d'Etat, dated December 29, 2006, *Ministre de l'Economie des Finances et de l'Industrie c/ Societe Bank of Scotland*, no. 283314; *Revue de Droit Fiscal* no. 4/2007, p. 34, section 87.

Limitation on Benefits Provisions Support a Restricted Interpretation of “Beneficial Owner”

73. The term “beneficial owner” was not intended to be a broad limitation of benefits rule or anti-treaty shopping rule.⁵⁶ The Commentary to the 1977 Model Treaty provides that countries should consider including additional specific provisions in their bilateral treaties to address any perceived abuses that they believe are not otherwise adequately addressed in the OECD Model.⁵⁷
74. The OECD has consistently recommended that contracting states consider adding LOB provisions to their bilateral tax treaties, in addition to the beneficial owner requirement, in order to combat perceived “abuses” of the treaty, including the use of conduit companies. Canada has limitation on benefits (“LOB”) clauses in almost half of its 86 treaties.⁵⁸
75. Moreover, international courts have recently reiterated the importance of including such LOB provisions in bilateral tax treaties if a contracting state seeks to restrict a treaty benefit that it does not consider appropriate in certain circumstances.⁵⁹

⁵⁶ Some speculation has arisen that the relieving or remedial origins of the use of the term “beneficial owner” was, in part, to provide relief for pensions and charities.

⁵⁷ Paragraphs 7 and 10 of the 1977 Commentary to Article 1 of the 1977 OECD Model; Paragraph 12 of the 1977 Commentary to Article 10 of the 1977 OECD Model; *M.I.L. (Investments) S.A. v. R.*, 2006 DTC 3307 (T.C.C.) [*M.I.L.*] at para. 84; aff’d 2007 FCA 236.

⁵⁸ See the chart at tab 2 of Exhibit A-1.

⁵⁹ *Union of India et al. v. Azadi Bachao Andolan et al.* [2003] I.N.S.C. 494 (India Sup. Ct.); *M.I.L.*, *ibid.*, at para. 84.

Summary of Meaning under Domestic and International Law

76. Under domestic law, the beneficial owner is the real and true owner of the property, and such ownership is not to be confused with beneficial entitlement. Beneficial ownership is not to be used as a broad limitation on benefits provision. In this case, B.V. was the real and true owner of the dividends as owner of the shares, and was not acting as an agent, nominee, mere fiduciary or administrator.
77. Under international law, the term “beneficial owner” is used to ensure that “agents and nominees” do not receive the benefit of the reduced withholding rate. Accordingly, an entity not acting in such a capacity is the beneficial owner of the property in question.⁶⁰

D. RESPONDENT’S THEORY OF CASE IS FLAWED

78. The arguments of the Respondent are flawed and do not support the reassessments.
79. There is no evidence that B.V. relinquished its beneficial ownership (as that term is used in Canadian law) in the dividends that flowed from its ownership of the shares of Prevost Car Inc. There is no evidence that B.V. acted as an agent, nominee, administrator or fiduciary of such dividends for Volvo and Henlys (as those terms are used in the OECD Commentary). Indeed, all of the evidence points to the conclusion that B.V. simply acted as a garden variety subsidiary of Volvo and Henlys.

⁶⁰ The Appellant notes that later OECD Commentary, though it cannot apply (see *M.I.L.*, *supra*), supports the position that B.V. as the beneficial owner of the dividends. See, for example, the current OECD Commentary on Article 11(2) clarifying that a conduit is not the beneficial owner of interest if the conduit is a mere fiduciary or administrator.

80. The Respondent's complaint in these appeals seems to be that one of the main purposes of the creation and maintenance of B.V. was to obtain benefits under the *Treaty*. Even if that were the case (and it is submitted that there is no evidence to support that assertion), it is clearly of no relevance in the determination of beneficial ownership under Article 10 of the Treaty or under Article 10 of the OECD Model. For more than 20 years the OECD has specifically rejected the notion that the concept of "beneficial ownership" can be used to deny treaty protection to an ordinary subsidiary.

81. The Crown seems to rely upon six principal points:

- (a) The shareholders had a right under Dutch law to declare dividends;
- (b) The historic record indicates that dividends paid by the Appellant to B.V. were shortly thereafter paid out by B.V. to its two shareholders, Volvo and Henlys;
- (c) B.V. had a distribution policy to pay out at least 80 percent of the Appellant's profits to its two shareholders, Volvo and Henlys;
- (d) Sometimes those dividends were paid out in advance of formal dividend declarations being signed (although in every case such declarations were signed);
- (e) Documentation filed with B.V.'s bank indicated that the beneficial owners of B.V. were Volvo and Henlys; and
- (f) B.V. had no employees or office in the Netherlands and its affairs were managed by a management company, T.I.M.

82. We will address each point in turn.

83. The uncontradicted evidence of Dr. Raas affirms that the shareholders rights under Dutch law has nothing to do with beneficial ownership;
84. The uncontradicted evidence of Tore Backstrom suggests that this was standard procedure within the corporate structure;
85. The distribution policy is completely inconsistent with a loss of beneficial ownership of the dividends. In order for this to be relevant the Respondent would have to argue that it was somehow a sham to disguise the fact that B.V. had already alienated its right to the dividends.
86. The payment by B.V. of dividends before the dividends were formally declared does not change the ownership status of the dividends received by B.V. Such payments are normally ratified in a formal declaration after the payment date. In fact, the CRA has acknowledged in another context that payments to shareholders before the declaration of a dividend is a common practice.⁶¹
87. The bank's anti-money-laundering documentation is not evidence of B.V. alienating its entitlement to the dividends or acting as an agent, nominee, fiduciary or administrator for Volvo and Henlys. Moreover, the Crown's evidence is that they relied upon this for their original GAAR allegation, and not as going to the issue of beneficial ownership.

⁶¹ *Attis v. Minister of National Revenue*, 92 D.T.C. 1128 (T.C.C.); *Nigel T. Hill and Uphill Holdings Ltd. v. Minister of National Revenue*, 93 D.T.C. 148 (T.C.C.); CRA, Interpretation Bulletin IT-119R4, "Debts of Shareholders and Certain Persons Connected With Shareholders" (7 August 1998); CRA Views, Tech Interp (external) 2003-0016705, "Shareholder loan account" (26 June 2003); and CRA Views 9524620, "Capacity in which a loan is received and running accounts" (12 October 1995).

88. The final point, that B.V. had no employees or office in the Netherlands and its affairs were managed by a management company, has already been rejected as evidence that beneficial ownership vested with another entity by both the courts and by the OECD: there is nothing improper about a holding company acting as a holding company.⁶²
89. Contrary to the view of the Respondent, the facts of the case establish the following:
- (a) The dividends were received by B.V. in its Dutch bank account;
 - (b) Neither Volvo nor Henlys had signing authority over this account and could not access these funds until if and when distributed by B.V. (through T.I.M.) under a separate dividend resolution passed by its board of directors;
 - (c) B.V. did not act (and the Minister did not assume nor did the Crown plead that B.V. acted) as an agent, nominee or trustee in receiving the dividends;
 - (d) B.V. was under no contractual obligation to distribute any amount of its profits to its shareholders or to distribute those profits in any particular form; and
 - (e) B.V. was legally and equitably entitled to reinvest the whole amount of the dividends if considered necessary.

⁶² See paragraph 20, *supra*. See also *Wood, supra*.

E. CONCLUSION

90. Whether one applies the Canadian meaning of “beneficial owner”:

the one who can at law exercise the rights of ownership in the property

or the OECD meaning:

*a party other than an agent or nominee*⁶³

there is no basis to conclude that B.V. was not the beneficial owner of these dividends.

91. The Respondent is attempting to persuade this Court to insert into the *Treaty* an implied term after the expression “beneficial owner”, that is, “none of the principal purposes of the creation and existence of which was to derive benefits under the convention in a manner that is not necessary and is not accepted by its Dutch treaty partner.” The Minister’s efforts in the current appeal are simply an attempt to resurrect the failed “implicit anti-abuse” rule that was explicitly rejected in *M.I.L.* Accordingly, this Court should reject the Respondent’s position as untenable.⁶⁴

92. There is a well-established principle in international tax law that a subsidiary is presumed to be the beneficial owner of its assets. That principle arises out of the need for a reasonable degree of certainty in international business transactions both for the business community and for revenue authorities. The position advanced by Respondent ignores

⁶³ The *1986 Conduit Report* and 2003 Commentary clarified that this was a party other than an agent, nominee, fiduciary or administrator.

⁶⁴ The Appellant reminds this Honourable Court that the practices with which the Minister takes issue here are common, and commonly accommodated, in CRA practice and relevant law dealing with closely held corporations in a domestic context. See, for example, the CRA documents and cases cited at footnote 61 (*Attis* etc.), *supra*.

this principle and can only lead to uncertainty and confusion in Canada's dealings with its treaty partners.

93. Moreover, if there were any legal impairment to, or alienation of, B.V.'s beneficial ownership of the dividends that would have to be demonstrated as a matter of Dutch law. The Respondent has adduced no evidence of Dutch law that would demonstrate any such impairment or alienation. The only evidence of Dutch law before the court is that of Dr. Raas which concludes that there was no such impairment to, or alienation of, the dividends.
94. Accordingly, the Appellant respectfully requests that these appeals be allowed in full.
95. The Appellant respectfully requests to be allowed to make separate representations on the question of costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 6th day of September 2007.

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