Back-to-Back withholding loan rules and their anti-treaty shopping effect in Canada

Reglas de retención en la fuente para préstamos indirectos y sus efectos en las normas antiabuso de los tratados en Canadá

Regras de aluguel na fonte para prestações indiretas e efeitos nas normas antiabuso dos tratados no Canadá

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Abstract

The Income Tax Act imposes withholding tax typically; article 11 of Canadian tax treaties allow Canada to tax interest arising in Canada and paid to residents of the other treaty country at a reduced rate of 10 or 15 percent from the statutory rate that could otherwise apply. Exclusively, under Canada-United States Treaty, no Canadian withholding tax applies to interest on non-arm's length debt, for example, when a Canadian subsidiary pays interest on money borrowed from its U.S. parent corporation. Nevertheless, as treaties are intended to provide tax benefits only to residents of the treaty countries, residents of third countries, for example, the parent of a multinational enterprise in a third country, might seek to arrange lending transactions indirectly through the United States or perhaps other countries to qualify for treaty benefits that would not otherwise be available on a direct loan from the ultimate lender or some other member of the corporate family. This is often called "treaty shopping," structuring loans to reduce the withholding tax to the least possible tax treaty rate. These arrangements generally may and frequently involve interposing a non-resident financial intermediary located in a tax treaty jurisdiction between a Canadian taxpayer and a resident of a non-ta treaty jurisdiction to reduce the withholding tax that would apply if a loan were made and interest paid on the loan directly. As a response, subsections 212(3.1) and 212(3.2) of the ITA provide specific *objective* rules to address back-to-back loan arrangements through treaty shopping schemes, attuned to the common commercial characteristics of commercial lending transactions and the interests of genuine self-interested participants in them.

Keywords: Consecutive Loans, Norms Against Treaty Elusion, Canada.

Resumen

La Ley del Impuesto sobre la Renta suele imponer retenciones en el origen. El artículo 11 de los tratados fiscales canadienses permite a Canadá gravar los intereses que surgen en el país y se pagan a los residentes del otro país del tratado a una tasa reducida del 10 % o 15 % de la tasa legal que de otro modo podría aplicarse. Exclusivamente, según el tratado entre Canadá y Estados Unidos, no se aplica ningún impuesto de retención canadiense a los intereses sobre deudas no realizadas en condiciones de plena competencia, por ejemplo, cuando una subsidiaria canadiense paga intereses sobre dinero prestado de su empresa matriz estadounidense. Sin embargo, como los tratados tienen por objeto proporcionar beneficios fiscales solo a los residentes de los países del tratado, los residentes de terceros países, por ejemplo, la matriz de una empresa multinacional en un tercer país, podrían tratar de concertar transacciones de préstamo indirectamente a través de los Estados Unidos o quizás otros países calificar para beneficios del tratado que de otro modo no estarían disponibles con un préstamo directo del prestamista final o de algún otro miembro de la familia corporativa. A esto a menudo se le llama "compra de tratados", estructurando préstamos para reducir la retención de impuestos a la tasa más baja posible del tratado fiscal. Estos acuerdos generalmente pueden y con frecuencia implican la interposición de un intermediario financiero no residente ubicado en una jurisdicción con un tratado fiscal entre un contribuyente canadiense y un residente de una jurisdicción sin un tratado fiscal para reducir la retención de impuestos que se aplicaría si se otorgara un préstamo y se pagaran los intereses. sobre el préstamo directamente. Como respuesta, las subsecciones 212(3.1) y 212(3.2) de la ITA establecen reglas objetivas específicas para abordar acuerdos de préstamos consecutivos a través de esquemas de compra de tratados, en sintonía con las características comerciales comunes de las transacciones de préstamos comerciales y los intereses de los inversores genuinos. participantes interesados en ellos.

Palabras clave: préstamos consecutivos, normas contra la elusión de tratados, Canadá.

Abstrato

A Lei do Imposto de Renda normalmente impõe imposto retido na fonte; o artigo 11 dos tratados fiscais canadenses permite que o Canadá tribute os juros provenientes do Canadá e pagos aos residentes do outro país do tratado a uma alíquota reduzida de 10 ou 15 por cento da alíquota legal que de outra forma poderia ser aplicada. Exclusivamente, ao abrigo do Tratado Canadá-Estados Unidos, nenhum imposto retido na fonte canadiano se aplica a juros sobre dívidas que não sejam de plena concorrência, por exemplo, quando uma subsidiária canadiana paga juros sobre dinheiro emprestado à sua empresa-mãe nos EUA. No entanto, como os tratados se destinam a proporcionar benefícios fiscais apenas aos residentes dos países tratados, os residentes de países terceiros, por exemplo, a empresa-mãe de uma empresa multinacional num país terceiro, podem procurar organizar operações de empréstimo indirectamente através dos Estados Unidos ou talvez outros países se qualifiquem para benefícios do tratado que de outra forma não estariam disponíveis num empréstimo direto do credor final ou de algum outro membro da família empresarial. Isto é muitas vezes chamado de "treat shopping", estruturando empréstimos para reduzir o imposto retido na fonte à menor taxa possível do tratado fiscal. Esses acordos geralmente podem e frequentemente envolvem a interposição de um intermediário financeiro não residente localizado em uma jurisdição de tratado fiscal entre um contribuinte canadense e um residente de uma jurisdição não-ta-tratado para reduzir o imposto retido na fonte que seria aplicado se um empréstimo fosse feito e os juros fossem pagos diretamente no empréstimo. Como resposta, as subsecções 212(3.1) e 212(3.2) do ITA fornecem regras objectivas específicas para

abordar acordos de empréstimo back-to-back através de esquemas de treaty shopping, em sintonia com as características comerciais comuns das transacções de empréstimo comercial e com os interesses de genuínos participantes interessados neles.

Palavras-chave: préstamos executados, normas contra a elusão de tratados, Canadá.

Introduction

The Income Tax Act (ITA) typically imposes withholding tax (WHT) on non-exempt interest payments to non-residents at 25 percent. However, article 11 of Canadian tax treaties allows Canada to tax interest arising in Canada and paid to residents of the other treaty country at a reduced rate of 10 or 15 percent from the statutory rate that could otherwise apply. Uniquely, under Canada-United States tax treaty, no Canadian withholding tax applies to interest on non-arm's length debt, for example, when a Canadian subsidiary pays interest on money borrowed from its U.S. parent corporation.

However, because treaties are intended to provide tax benefits only to residents of the treaty countries, residents of third countries, for example, the parent of a multinational enterprise (MNE) in a third country, might seek to arrange lending transactions indirectly through the United States or perhaps other countries to qualify for treaty benefits that would not otherwise be available on a direct loan from the ultimate lender or some other member of the corporate family. This is often called "treaty shopping," structuring loans to reduce the withholding tax to the least possible tax treaty rate. These arrangements generally may and frequently would involve interposing a non-resident financial intermediary (e.g., a foreign bank or possibly another group member resident in a jurisdiction with a "better" treaty with Canada than that that would apply directly) located in a tax treaty jurisdiction between a Canadian taxpayer and a resident of a non-ta treaty jurisdiction (i.e., the real or ultimate lender) to reduce the withholding tax that would apply if a loan were made and interest paid on loan directly.

As a response, subsections 212(3.1) and 212(3.2) of the ITA provide specific objective rules to address back-to-back loan arrangements through treaty shopping schemes, attuned to the common commercial characteristics of commercial lending transactions and the interests of genuine self-interested participants in them. In addition to domestic tax law and bilateral tax treaties, the Multilateral Convention to Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting (MLI) came into force on July 1, 2018, and has been signed by 100 jurisdictions, including Canada.[1] The most important provisions of the MLI are the preamble text of article 6(1) and the general anti-avoidance provision of the principal purpose test (PPT) of Article 7(1), which states that benefit covered tax agreement would be denied where it is "reasonable to conclude", having

1 Organisation for Economic Co-operation and Development, "Multilateral Convention to Implement Tax Treaty Related Measures To Prevent BEPS" Paris: OECE, November 24, 2016). [MLI].

regard to all relevant facts and circumstances, that "one of the principal purposes" of the arrangement or transaction was to gain the benefit unless it is established that granting that benefit would be in accordance with the object and purposes of the relevant provisions of the tax treaty.

Therefore, in Canada, there are three regimes to combat the treaty shopping schemes through back-to-back loan arrangements. First, Subsections 212(3.1) and 212(3.1) state the back-to-back loan rule more narrowly or mechanically. Second, the broad and subjective PPT of the MLI that is included in many of Canada's bilateral tax treaties.[2] Third, the Limitation on Benefits (LOB) provision of Article XXIX A of the Canada – the US tax treaty. This paper addresses how the statutory back-to-back loan rules in subsections 212(3.1) and 212 (3.2) effectively address treaty shopping without resorting to losing notions of anti-avoidance but instead by looking at the fundamental interests of parties to those arrangements through the lens of objectively verifiable commercial practice. Accordingly, I attempt to answer the following questions: (1) Are the back-to-back loan rules (and the related rules dealing with the transformation of payments of one kind to be payments of another) found starting at subsection 212(3.1) of the ITA really "anti-treaty shopping" rules? and; (2) Are they likely to be more effective than the kinds of anti-treaty shopping initiatives argued by the CRA in cases like *MIL (Investments) SA* (2007 FCA)[3] and *Alta Energy* (2021 SCC)[4] and *like* notions found in Articles 6 (i.e., income from immovable property), 7 (i.e., business profit) and 13 (capital gains) of another bilateral Instrument? In this paper, I argue that the back-to-back loan rules effectively eliminate the treaty benefits, addressing the perceived treaty-shopping issue.

On the other hand, based on the absence of PPT on the back-to-back loan rules, some authors affirmed that there is a risk that the back-to-back loan rules could deny treaty benefits for ordinary commercial arrangements.[5] For instance, the cash-pooling intra-group arrangements provide significant commercial advantages, such as the interest rate payable by a participating company on borrowings from the cash pool, usually lower than the rate charged by arm's-length borrowers. Given that the mechanical application of Subsection 212(3.1) and 212 (3.2), under the back-to-back loan rules, would be a risk of denying treaty benefits for ordinary legitimate commercial arrangements?

The roadmap of the paper is as follows (1) withholding tax relief of tax treaties, (2) the definition of what is treaty shopping, (3) back-to-back loan arrangements for treaty shopping, (4) the back-to-back as anti-treaty shopping loan rules, (5) the conditions to qualify

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2 Heale, Amanda, Simplifying the Taxation of Inbound Investment, 2020 Conference Report (Toronto: Canadian Tax Foundation, 2020) 12: 1-23. [*Simplifying the Taxation of Inbound Investment, 2020*].

3 Canada v. MIL (Investments) SA [2007] FCA 236; aff'g. 2006 TCC 460 [*MIL Investment*].

4 Alta Energy Luxembourg SARL v. The Queen, 2018 TCC 152; aff'd. 2021 SCC 49 [*Alta Energy*].

5 Bradley, Ian, Kwan Denny, and Wan, Dian, Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure? International Tax Planning feature, (2016) 64:4 Canadian Tax Journal 833-858 [*Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure?*].

a scheme under Subsection 212(3.1), (5) the causal connection test, (5) deemed interest payments under Subsection 212(3.2), (6) the analysis of the back-to-back loan rules as effective anti-avoidance treaty shopping rules.

I. Treaty shopping Arrangements

A. Withholding Tax and the Legal Effects of Canadian Tax Treaties

1. Meaning of Interest

Given that the primary goal of the implementation of back-to-back-back loan arrangements is the reduction or elimination of the WHT regarding the payment of interest, it is necessary to address its meaning for tax purposes. As with every keyword of the Canadian tax code, such as income, royalties, profits, etc., the term interests is undefined by the ITA, which means that such a definition should follow the common law rules provided by the courts to supplement the statutory language.[6]

The Canadian residence of the payer, the Canadian situs of real property used as security for the indebtedness, or a business carried on in Canada triggers the WHT on the interest payment. In this vein, according to paragraph 212(1)(b) of the ITA, interest payments made or credited to non-residents are subject to the WHT at a rate of 25 percent if it is not "fully exempt" interest and is paid or payable in respect of a debt or other obligation to pay an amount to a non-arms length´s person (i.e., related party).[7] Fully exempt interest is defined to include interest paid to an arm's length non-resident lender, Canadian government debts (e.g., the interest from Canada Savings Bonds), real property mortgages and specific commercial lending arrangements (s. 212(3)).[8] As such, interest paid to an arm's length non-resident lender is the main category of interest exempt from withholding tax.[9]

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6 Jinyan Li, Arthur Cockfield, and J. Scott Wilkie, International Taxation in Canada, 4th ed., (Toronto, LexisNexis Canada, 2018. [*International Taxation in Canada*], at p. 217.

7 *Ibid*, p. 215.

8 In this sense, "A useful definition can be found in the decision of the *England and Wales Court of Appeal in Pike v. Revenue and Customs Commissioners, [2014] EWCA Civ. 824 at para. 18(C.A.)*: "First, it is calculated by reference to an underlying debt. Second, it isa payment made according to time, by way of compensation for the use of money. Third, the sum payable accrues from day to day or at other periodic intervals. … Fifth, what the payment is called is not determinative…." Whether a payment is interest is generally determined by the legal substance in terms of the legal rights and obligations of the parties. Typical legal at tributes of a debt include: the investor is legally entitled to fixed, periodic payments, but has no right to participate in corporate management; there is a fixed maturity date; and the investor has priority in claims over the corporate assets in the event of bankruptcy." Quoted from, International Taxation in Canada, supra note 6, p. 215.

9 Given this, "[a] participating debt interest" is defined in subsection 212(3) as interest "that is paid or payable on any obligation, other than a prescribed obligation, all or any portion of which interest is contingent or dependent on the use of or production from the property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders

By contrast, interest paid or payable on participating debt between arm's length parties stays taxable as this interest is, in effect, a distribution of profits or the like (s. 212(1)(b)(ii) and s. 212(3)). As a result, this kind of interest is treated as dividends for WHT purposes.[10]

On the other hand, Canadian tax treaties define "interest" widely to include debt claims of every kind as well as income assimilated to income from money lent by the taxation laws of the country in which the income arises, amongst others (e.g., Article XI (4) of the Canada-U.S. Treaty).[11] Canadian tax treaties also adopt the income source rule in Article 11(5) of the Organisation for Economic Co-operation and Development (OECD) Model, which is the payer's residence or the permanent establishment's location (or fixed base) that bears the interest expenses.[12]

2. Withholding tax´s Relief of Tax Treaties

Double tax treaties usually offer reliefs to the WHT applicable to payments to a resident of the other Contracting State of dividends, royalties, services, interest, etc. In this sense, Article 11 of the OECD model´s Canadian tax treaties reduces the rate of the WHT for the interest payments to non-residents to 10 or 15 percent.[13] However, because of the broad exemptions under paragraph 212(1)(b), the only significant kind of interest requiring treaty relief is paid to non-arm's parties.[14] Moreover, under the Fifth Protocol to the Canada-U.S. Treaty, Canadian WHT would not apply, for instance, when a Canadian subsidiary pays interest on money borrowed from its U.S. parent corporation. However, non-arm's length interest paid to non-U.S. corporations will remain subject to WHT.

Therefore, given that the only kind of interest requiring treaty relief is those paid to non-arm's parties and the Canada-U.S. relief interest payments to U.S. parent corporations, these differences would create opportunities for tax arbitrage. For instance, payments from a Canadian taxpayer to a non-resident would be routed through an intermediary that benefits from a more favourable WHT regime than would apply if the payments were made directly to the ultimate recipient of the funds.[15]

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of any class of shares of the capital stock of the corporation." Quoted from, International Taxation in Canada, supra note 6, p. 216.

10 International Taxation in Canada, supra note 6.

11 *Ibid*, p. 217.

12 *Ibid*.

13 For instance, Article 11 (2) of the Double Tax Treaty between Colombia and Canada states: "However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest."

14 International Taxation in Canada, supra note 6, p. 217.

15 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure? supra note 5.

B. Back-to-Back Loans arrangements for treaty shopping

1. CASE LAW DEVELOPMENTS

Members of a multinational corporate groups would consider arranging for a non-resident family member to deposit with an intermediary, which, in turn, would extend a loan to a Canadian borrower related to the depositor. These transactions are known as back-to-back loan arrangements, which would be considered in some instances as treaty shopping transactions where the intermediary is in a jurisdiction in which Canada imposes a lower withholding tax rate.[16]

Four well-known court decisions have influenced the development of Canada's approach to treaty shopping. These are *MIL Investments SA* (2007 FCA)[17], *Velcro Canada Inc*. (2012 TCC)[18], *Prévost Car Inc*. (2009 FCA)[19] and Lehigh (2010 FCA)[20]. First, in *MIL Investment*, the courts rejected the minister's argument that an inherent anti-abuse rule would be read into the relevant tax treaty, despite the treaty containing no explicit provisions to counter treaty shopping.

Prévost Car and *Velcro,* the Minister, denied the treaty rate of withholding tax on Canadian-source payments to a treaty country because the recipient was not the beneficial owner of the payments but was merely a conduit for payments to the ultimate recipient. However, in both cases, the courts considered the recipient's functions and activities, concluding that the recipient was the beneficial owner of the Canadian-source payments rather than a mere agent, nominee, or conduit.[21]

Lehigh is a significant case, provided paragraph 212(1)(b) was amended in 2013 in response to said decision. In *Lehigh*, an arrangement was structured to avoid the WHT so that the debt owed by the taxpayer to its related Belgian company was divided. The right to receive interest was assigned to an unrelated party, while the right to receive repayment of the principal remained with the non-arm's length company. The Court held that the payments to the arm's length party fell within the former exemption under subparagraph 212(1)(b)(vii), and the general anti-avoidance rule (GAAR) did not apply. The amended paragraph 212(1)(b) looks to the debt itself instead of the interest in determining whether the non-resident person is at arm's length with the Canadian borrower. In the *Lehigh*

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16 Jason Boland and Christopher Montes, A Detailed Review of the Back-to-Back Loan Rules, in Report of Proceedings of the Sixty-Eighth Tax Conference, 2016 Conference Report (Toronto: Canadian Tax Foundation, 2017), 26:1-32 [*A Detailed Review of the Back-to-Back Loan Rules*].

17 Canada v. MIL (Investments) SA *[*2007] FCA 236; aff 'g. 2006 TCC 460 [*MIL Investment*].

18 Velcro Canada Inc. v. Canada, [2012] T.C.J. No. 49, [2012] 4 C.T.C. 2029, 2012D.T.C. 1100 (T.C.C.) [*Velcro*].

19 Prévost Car Inc. v. Canada [2009] FCA 57; aff'g. 2008 TCC 231 [*Prévos*].

20 Lehigh Cement Ltd. v. Canada, [2010] F.C.J. No. 658, [2010] 5 C.T.C. 5081,2010 D.T.C. 5081 (F.C.A.) [*Lehigh*].

21 *Ibid*.

scenario, the interest would now be taxable under paragraph 212(1)(b).[22] This kind of interest is treated as dividends for WHT purposes.[23] Therefore, as mentioned above, the amended paragraph 212(1)(b) provides that interest is subject to the WHT if it is not fully exempt interest and is paid or payable regarding a debt or other obligation to pay an amount to a non-arm's length person.

2. What is «treaty shopping»?

As discussed above, because treaties are intended to provide tax benefits only to residents of the treaty countries, residents of third countries, the parent of an MNE in a third country would seek to arrange lending transactions indirectly through the United States or other countries to qualify for tax treaty reliefs that would not otherwise be available on a direct loan from the ultimate lender or some other member of the international corporate group (i.e., using legal intermediation). Such strategies are typically referred to as treaty shopping, which the Canadian government views as abusing its bilateral tax treaties.[24] Examples include a tax-motivated change of residence shortly before the disposition of property to obtain a treaty exemption on the taxation of capital gains and conduit arrangements whereby a resident of one state directs an investment through a legal entity in a third state to obtain treaty benefits under that state's tax treaty with the ultimate source state (e.g., *Alta Energy*).[25]

In *Alta Energy*, the SCC defined treaty shopping as a "[…] premeditated effort to take advantage of the international tax treaty network, and careful selection of the most favorable treaty for a specific purpose […]. Treaty shopping typically involves the practice of non-residents establishing a minimal presence or economic activity in a country in order to benefit from the jurisdiction's treaty network with other countries".[26] In addition, the SCC in *Alta Energy* held that not all types of treaty shopping are abusive, only when an avoidance transaction frustrates the rationale of the relevant treaty provision. Then, the tax benefit would be denied.[27]

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22 International Taxation in Canada, supra note 6.

23 Subsection 212(3) defines "participating debt interest" i as interest "that is paid or payable on any obligation, other than a prescribed obligation, all or any portion of which interest is contingent or dependent on the use of or production from the property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of the corporation".

24 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

25 David G. Duff, Tax Treaty Abuse and the Principal Purpose Test—Part 1, International Tax Planning feature (2018) 66:3 Canadian Tax Journal 619-677[*Tax Treaty Abuse and the Principal Purpose Test—Part 1*].

26 Alta Energy, supra note 4, para 182.

27 *Ibid*, para 188.

Similarly, the OECD and the G20 in the BEPS project address specific international tax-avoidance issues. Action 6 Action Plan on Base Erosion and Profit Shifting concerns granting treaty benefits in inappropriate circumstances.[28] The final report on action 6 of BEPS defines treaty shopping as:

"There are a number of arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State. These arrangements are generally referred to as "treaty shopping." Treaty shopping cases typically involve persons who are residents of third States attempting to access indirectly the benefits of a treaty between two Contracting States."[29]

In short, the final report on Action 6 recommended the following treaty-based approaches to address treaty shopping:[30] (i) A clear statement in all tax treaties that the contracting states intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements; (ii) A specific anti-abuse rule, consisting of a limitation-on-benefits (LOB) rule like the rule in the tax treaty between Canada and the United States; (iii) A general anti-abuse rule in the form of a "principal purpose test," where treaty benefits are denied if one of the principal purposes of transactions or arrangements were to obtain those benefits unless it is established that granting the benefits would be by the object and purpose of the treaty provisions.[31]

As a development of Action 6, the MLI came into force on July 1, 2018, modified existing tax treaties focusing on cracking down on international "treaty-shopping" not captured under existing bilateral tax treaties, and has been signed by 100 jurisdictions, including Canada. Today, Canada and many of its treaty partners have ratified the MLI (the U.S. relies on the LOB provision in its bilateral tax treaties to address treaty shopping concerns).[32] The MLI introduces a third set of rules for the taxation of cross-border transactions, in addition to domestic tax law and bilateral tax treaties.

The most important provisions of the MLI are the preamble text of article 6(1) and the general anti-avoidance provision of the PPT of Article 7(1). The PPT states that a treaty benefit may be denied where it is reasonable to conclude that one of the principal purposes of the arrangement or transaction in question was to gain the benefit unless it is established that granting that benefit would be in accordance with the object and purposes

28 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

29 Organization for Economic Co-operation and Development, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6—2015 Final Report* (Paris: OECD, October 5,2015) (herein referred to as "the action 6 report"), at p 17.

30 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

31 *Ibid*.

32 Marshall, Steve and Maurice, Craig, Advising on Inbound Investment, in 2022 Prairie Provinces Tax Conference, (Toronto: Canadian Tax Foundation, 2022), 9: 1-100 [*Advising on Inbound Investment*].

of the relevant provisions of the treaty. All signatories have adopted both provisions to the MLI to satisfy the OECD's minimum standard on tax treaty abuse under BEPS action 6.[33]

Analyzing the domestic legislation, Canadian courts have reiterated that there is no general policy under the ITA against treaty shopping arrangements or most of Canada's tax treaties (except for the LOB provision in the Canada-US Tax Treaty[34]).[35] Nevertheless, a general policy against creating opportunities for treaty shopping would be central to the purpose of the MLI. Therefore, arrangements not previously caught by the GAAR under section 245 of the ITA would be captured by the anti-treaty shopping provisions in the preamble text of article 6(1) and the general anti-avoidance provision of the PPT of Article 7(1) of the MLI.[36]

In *MIL Investments*, a corporate taxpayer moved from the Cayman Islands (which had no tax treaty with Canada) to Luxembourg and diluted its shareholders to below 10% before disposing of its shares in a Canadian corporation to benefit from the treaty exemption on capital gains tax under Article 13 of the Canada-Luxembourg tax treaty. In this case, the Minister unsuccessfully attempted to apply GAAR to the transaction. Moreover, *Alta Energy* was similarly involved in using a treaty exemption for capital gains on dispositions of taxable Canadian property (TCP) under the Canada-Luxembourg tax treaty. Again, the Minister unsuccessfully attempted to apply GAAR to the transaction.

While in both *MIL Investments* and *Alta Energy,* the Courts sided with the taxpayer and refused to apply the GAAR, these types of arrangements may be found to be a form of treaty shopping under the MLI in future.[37] In this vein, the SCC in *Alta Energy* indicated in passing that those transactions, such as the one at issue in that case, could be considered differently in future under the MLI[38], as Canada signed most of its bilateral tax treaties

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33 Tax Treaty Abuse and the Principal Purpose Test—Part 1, supra note 25.

34 See *MIL Investments*, supra note 3, and Alta Energy, supra note 3.

35 Advising on Inbound Investment, supra note 32.

36 *Ibid*.

37 Advising on Inbound Investment, supra note 32. In this vein, the SCC in *Alta Energy*, at para 87, held: "The absence of any such anti-avoidance measure that would have limited access to the carve-out in a treaty with a country known for not taxing capital gains leads me to believe that Canada weighed the pros and cons and concluded that its national interest in attracting foreign investors, using Luxembourg as a conduit to take advantage of the carve-out, outweighed its interest in collecting more tax revenues on such capital gains. This answers the question of "why the benefit was conferred" posed under the GAAR (*Canada Trustco*, at para. 66). This choice must also have been motivated by the fact that Canada was not keen on going its own way at a time when the international community was not yet as serious about curtailing treaty shopping as it was during the years leading to the signature and ratification of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, Can. T.S. 2019 No. 26, in 2017 and as it has remained to this day (see Multilateral Instrument in Respect of Tax Conventions Act, S.C. 2019, c. 12; Arnold (2009), at p. 18). As a relatively small country, "Canada does not have the luxury of setting its own policy without considering what other countries do", and it must have rightly seen multilateralism as the way forward (Li and Cockfield, at p. 25)."

38 Advising on Inbound Investment, supra note 32.

before ratifying the MLI and before making concerted efforts to prevent treaty shopping.[39] For example, note that for Canada's treaty partners that have ratified the MLI, such as Luxembourg and the Netherlands, the MLI became effective for withholding taxes on January 1, 2020, and other taxes, including capital gains, for tax years beginning on June 1, 2020.[40]

II. Are the Back-to-Back loan Rules antitreaty Shopping Rules?

A. Policy Rationales for the Back-to-Back Rules

These arrangements generally involve interposing a non-resident financial intermediary (e.g., a foreign bank or possibly another group member resident in a jurisdiction with a "better" treaty with Canada than that would apply directly) located in a tax treaty jurisdiction between a Canadian taxpayer and a resident of a non-ta treaty jurisdiction to reduce the withholding tax that would apply if a loan were made and interest paid on loan directly.[41]

There are two main policy rationales for the back-to-back rules. First, specific rules in the ITA that require income inclusions or impose limitations on deductions and withholding tax obligations may not apply to transactions between arm's-length parties. In the absence of back-to-back rules, it may be possible for two non-arm's-length parties to enter a back-to-back arrangement with an arm's-length party to avoid applying those rules.[42] This is true for the thin capitalization rules, the interest withholding tax rules, and the shareholder loan rules, but this rational is beyond the scope of this paper.[43]

39 *Ibid*.

40 Online resource, cited from: https://www.bennettjones.com/Blogs-Section/The-Multilateral-Instrument-and-Canadian-Tax-Planning-Considerations#:~:text=The%20MLI%20contains%20a%20broad,accordance%20with%20the%20object%20and.

41 A Detailed Review of the Back-to-Back Loan Rules, supra note 16.

42 *Ibid.*

43 For instance, in the case of this capitalization rules the fectos is […] the back-to-back rule in subsection 18(6.1) applies with the following consequences. First, for the purposes of subsections 18(4) and (5), the particular debt will be deemed to be owing by the taxpayer to the particular non-resident, not to the intermediary, to the extent that the particular non-resident can be considered to have effectively funded the particular debt.26 Second, for the purposes of subsections 18(4) and (5), the proportion of interest paid or payable on the particular debt that effectively is attributable to the deemed debt is deemed to be paid or payable by the taxpayer to the particular non-resident and not to the intermediary.27 Finally, for the purposes of part xiii and subject to subsections 214(16) and (17), interest deemed to be paid or payable to the particular non-resident, to the extent that it is not deductible by virtue of subsection 18(4), is deemed to be paid or payable by the taxpayer to the particular non-resident, not to the intermediary. This effectively treats the deemed interest that is not deductible because of the thin capitalization rules as a dividend paid (subject to part xiii withholding tax) from the taxpayer to the particular non-resident." Quoted from, A Detailed Review of the Back-to-Back Loan Rules, supra note 16.

The second rationale is that the back-to-back rules are an anti-treaty shopping measure. Without back-to-back rules, it would be possible for an entity in a jurisdiction in which Canada imposes a high withholding tax rate to use an intermediary in a jurisdiction in which Canada imposes a lower withholding tax rate. Unless the Canada Revenue Agency (CRA) successfully challenged the availability of a reduced treaty withholding tax rate on the basis that the non-resident was not resident in the treaty jurisdiction or did not have beneficial ownership of the amount received, or that the general anti-avoidance rule applied, the total withholding tax obligation would be reduced.[44]

B. Statutory Framework of the Back-to-Back Loan Rules

The effect of legal intermediation (i.e., the use of a non-resident business or legal entity within a cross-border structure) is a compelling challenge in international tax law. A non-resident intermediary would function as (i) a "conduit" to flow payments from a Canadian corporation to an ultimate investor who deals at non-arm's length with the corporation to avoid the Canadian WHT (i.e., back-to-back loan arrangements) and; (ii) a "converter" by substituting one kind of payment for another for Part XIII purposes (e.g., back-to-back royalty arrangements- character substitution of Subsection 212(3.1) and 212 (3.7)).[45] The "conduct" and the "converter" functions have implications for treaty purposes.[46]

It is important to mention that in contrast to the back-to-back loan arrangement rules, the back-to-back royalty arrangement rules include a limited tax-avoidance purpose test. Although this limited tax-avoidance purpose test is intended as a relieving provision, it is unclear whether it provides any meaningful relief since it still requires the Canadian taxpayer to assess any back-to-back tax-avoidance purpose of the (third-party) licensor under the specified royalty arrangement.[47]

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44 A Detailed Review of the Back-to-Back Loan Rules, supra note 16.

45 International Taxation in Canada, supra note 3, p. 211.

46 "In a converter arrangement, the front-end transaction has a different character from the back-end transaction. Examples are debt/equity arrangements and debt/licensing arrangements. In a debt/equity back-to-back arrangement, a dividend is substituted for interest for withholding tax purposes. One of the purposes of the character substitution is to avoid Canadian withholding taxes when the different character of payments attracts different level of taxes. For example, arm's length interest payments are exempt from tax, but dividends or royalties are not. Under some tax treaties, royalties are subject to lower rate of withholding tax than dividends. […] The "converter" function of intermediaries is addressed by the "character substitution" rules in subsections 212(3.6) and (3.7) and subsections212(3.92) and (3.93)." Quoted from International Taxation in Canada, supra note 3, p. 211-212.

47 Diksic, Nik and Wong, Sabrina, Cross-Border Lending Practices, in Report of the Proceedings of the 69th Tax Conference, 2017 Conference Report (Toronto: Canadian Tax Foundation, 2018), 21:1-29. [Cross-Border Lending Practices].

In a "conduit arrangement," the "front-end transaction" (between the Canadian taxpayer and the intermediary) has the same character as a "back-end transaction" (between the intermediary and the ultimate non-arm's length lender). Therefore, the interest would qualify for "exempt interest" under paragraph 212(1)(b), an exempt payments interest on money borrowed from a U.S. parent corporation under the Canada-US treaty or obtain a tax treaty relief under an OECD model convention (i.e., reducing the WHT to 10 or 15 percent).[48]

C. Conditions (Detecting Whether the Direct Funder of a Loan, the Lender, is "Really" the Lender)

Subsections 212(3.1) and 212(3.2) of the ITA provide specific objective rules to address back-to-back loan arrangements, which address situations in which one or more "ultimate funders" (i.e., the real lender) indirectly provide funding to a Canadian taxpayer through "relevant funding arrangements" involving one or more intermediaries (e.g., a financial institution such a bank). In this sense, subsection 212(3.2) applies where all five conditions in subsection 212(3.1) are satisfied.[49]

Besides, the real lender is also defined in subsection 212(3.8), and essentially refers to a relevant funder that either (1) does not receive funding under any incoming funding arrangements or (2) provides a greater amount of funding under outgoing funding

48 International Taxation in Canada, supra note 6, p. 211.

49 These conditions would be summarized as follows: 1. A taxpayer pays or credits interest in respect of a particular debt or other obligation to pay an amount ("the immediate debt") to a person or partnership ("the immediate funder"). 2. The immediate funder is not a Canadian-resident person that does not deal at arm's length with the taxpayer or a partnership each member of which is such a person. 3. A relevant funder receives funding under a relevant funding arrangement (an "incoming funding arrangement"), which is connected to a particular relevant funding arrangement (an "outgoing funding arrangement") in one of the following ways: a. the incoming funding arrangement is a debt or other obligation to pay an amount to a person or partnership where (i) recourse in respect of the incoming funding arrangement is limited to a relevant funding arrangement, or (ii) it can reasonably be concluded that the outgoing funding arrangement was entered into (or permitted to remain in effect) because the incoming funding arrangement was entered into (or permitted to remain outstanding), or the relevant funder anticipated that the incoming funding the arrangement would become owing or remain outstanding; or b. the incoming funding arrangement is a specified right in respect of a particular property that was granted directly or indirectly by a person or partnership, and (i) the existence of the specified right is required under the terms and conditions of the outgoing funding arrangement, or (ii) it can reasonably be concluded that the outgoing relevant funding arrangement was entered into (or permitted to remain in effect) because the specified right was granted or the relevant funder anticipated that the specified right would be granted. 4. The part XIII tax that would be payable on the interest if the interest were paid or credited to any ultimate funder rather than the immediate funder exceeds the part XIII tax payable on the actual interest (determined without reference to the back-to-back loan rules). 5. The total amount of all funding provided to the immediate funder under relevant funding arrangements is equal to at least 25 percent of the immediate debt and certain related debts owing to the immediate funder. Cited from, Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

arrangements than it receives under incoming funding arrangements. In other words, the back-to-back loan rules would also apply to a chain of relevant funding arrangements in which one or more ultimate funders (i.e., real lenders) provide funding through multiple intermediaries.[50]

D. The Causal Connection Test (“relevant Funder” and “Relevant Funding Arrangement)

As the back-to-back loan rules are specific and primarily mechanical, these anti-avoidance rules would leave little room (or nothing) for considering purposes. In this context, an arrangement that satisfies the mechanical tests in subsection 212(3.1) would automatically be subject to the back-to-back rules, even though it has no tax-avoidance purpose.[51]

The critical condition is the connection test in paragraph 212(3.1)(c). Generally speaking, this test contemplates the following types of connections: (1) limited-recourse connections; (2) causal connections between the relevant funder (or “ultimate funder” or “real funder”) and relevant funding arrangement (clause 212(3.1)(c)(i)(B));[52] and (3) certain connections involving specified rights (subparagraph 212(3.1)(c)(ii)).

Under clause 212(3.1)(c)(i)(A)), the causal connection tests in the back-to-back rules apply if a particular funding (or royalty) arrangement would be “reasonably be considered” to have been entered into because of another such arrangement. However, some of the language used in the back-to-back rules—such as the wording of the causal connection tests—is still quite broad and appears to leave significant room for interpretation.[53] Generally, the back-to-back anti-avoidance rules seek to identify when the Canadian taxpayer and the relevant funder have sufficient connections to allow the ITA to ignore the intermediation.[54]

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50 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

51 *Ibid*.

52 Section 212(3.1)(c)(i)(B) of the ITA states: “(3.1) Back-to-back loan arrangement [conditions for 212(3.2) to apply] Subsection (3.2) applies at any time in respect of a taxpayer if (c) at any time in the period during which the interest accrued (in this subsection and subsections (3.2) and (3.3) referred to as the “relevant period”), a relevant funder, in respect of a particular relevant funding arrangement, (i) has an amount outstanding as or on account of a debt or other obligation to pay an amount to a person or partnership that meets any of the following conditions: (B) it can “*reasonably be concluded*” that all or a portion of the particular relevant funding arrangement was entered into.” (Emphasis added)

53 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

54 International Taxation in Canada, supra note 6, p. 230.

E. Deemed Interest Payments

Where subsection 212(3.2) applies, the taxpayer will be deemed to have paid an amount of interest to each ultimate funder for Paragraph 212(1)(b).[55] In other words, subsection 212(3.2) deems a Canadian taxpayer to have made a fictional interest payment to the ultimate funder for withholding tax purposes and thus denies the tax exemption that would otherwise be available to arm's length payment.[56]

The amount of deemed interest paid to a particular ultimate funder is equal to the amount of actual interest multiplied by (1) the proportion of the immediate debt that is ultimately funded by that ultimate funder and (2) the difference between the rate of part XIII tax on interest paid to the ultimate funder and the rate on interest paid to the immediate funder as a proportion of the withholding tax rate on interest paid to the ultimate funder.[57]

F. Back-to-Back Loan Rules as an Effective Anti-Avoidance Treaty Shopping Rules

The *Duke of Westminster* case established that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable.[58] In the same manner, in *Canada Trustco Mortgage Co. v. Canada* (2005), the SCC held that "[t]his would offend the goal of the Act to provide sufficient certainty and predictability to permit taxpayers to intelligently order their affairs".[59] With this in mind, specific anti-avoidance rules like the back-to-back regime may encourage taxpayers to structure their loan arrangements to reduce the tax burden, for example, through treaty shopping arrangements.

In Canada, three regimes combat the treaty shopping schemes through back-to-back loan arrangements. First, the back-to-back loan rule in subsections 212(3.1) and 212(3.2), in a narrower or mechanical set of conditions, also functions to deny treaty benefits (e.g., where both the immediate and ultimate funders are not dealing at arm's length with the Canadian taxpayer, and the immediate funder is entitled to a lower treaty-based rate of withholding tax than the ultimate funder). Second, the PPT of the MLI rule included in

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55 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

56 International Taxation in Canada, supra note 6, p. 232.

57 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5. A formula stated in subsection 212(3.2) determines the amount of deemed interest.

58 Inland Revenue Commissioners v. Duke of Westminster, (1935) [1936] A.C. 1 (H.L.) [Duke of Westminster].

59 Canada Trustco Mortgage Co. v. Canada, [2005] 5 C.T.C. 215 (S.C.C.) 2005 D.T.C. 5523 [Canada Trustco], at para 75.

many of Canada's bilateral tax treaties is also a mechanism to address treaty shopping.[60] Third, the Limitation on Benefits (LOB) provision of Article XXIX A of the Canada – the US tax treaty.

Although the back-to-back rules are not based on PPT, these tests may still be relevant when seeking benefits under many tax treaties.[61] In this context, the PPT could be an additional obstacle to claiming treaty benefits but could not relieve legitimate commercial arrangements caught by the back-to-back rules.[62] As a result, while the absence of PPT in the back-to-back rules increases the risk of these rules being over-inclusive concerning ordinary commercial arrangements, it may not significantly increase the risk of under-inclusion concerning tax-motivated transactions.[63] Viewed this way, back-to-back loan rules would be considered an objective effective way to fight against "treaty shopping."

For instance, the back-to-back loan rules could catch cash-pooling arrangements upon the satisfaction of the causal connection test of clause 212(3.1)(c)(i)(B). In a notional cash-pooling arrangement, the members of a multinational group (including many nonresidents) deposit surplus cash with an arm's-length bank, which lends cash to other group members (including Canadian residents) to meet their operating needs.[64] The cash-pooling arrangement may be structured so that the bank lends funds to group members only to the extent that other group members have deposited funds with the bank. Cash-pooling intra-group arrangements provide significant commercial advantages, such as the interest rate payable by a participating company on borrowings from the cash pool, usually lower than the rate charged by arm's-length borrowers.[65]

MIL Investments and *Alta Energy* were involved in treaty shopping strategies using the Canada-Luxembourg tax treaty to benefit from the treaty exemption on capital gains tax under Article 13. In both cases, the Minister unsuccessfully attempted to apply GAAR to the transactions. In *MIL Investment*, the courts rejected the minister's argument that an inherent anti-abuse rule would be read into the relevant tax treaty, despite the treaty containing no explicit provisions to counter treaty shopping. In *Alta Energy,* the approach of the SCC was similar. Still, at least, the SCC indicated in passing that those transactions, such as the one at issue in that case, could be considered differently in future under the MLI.

There is a criticism against the narrow approach of the back-to-back loan rules as an anti-treaty shopping mechanism. Because the PPT rule is included in many of Canada's

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60 Heale, Amanda, Simplifying the Taxation of Inbound Investment, 2020 Conference Report (Toronto: Canadian Tax Foundation, 2020) 12: 1-23. [*Simplifying the Taxation of Inbound Investment, 2020*].

61 Is the Back-to-Back Withholding Tax Regime an Effective Anti-Treaty-Shopping Measure, supra note 5.

62 *Ibid*.

63 *Ibid*.

64 *Ibid*.

65 *Ibid*.

bilateral tax treaties, it should be the mechanism by which Canada and those treaty partners have chosen to address treaty shopping.[66] In this framework, it would be understood inappropriate or unnecessary to have domestic provisions intended to address treaty shopping, given that they duplicate the bilateral tools available to the CRA to combat abusive treaty shopping, or they run contrary to Canada's treaty obligations and are therefore of no effect unless they explicitly override those obligations. Moreover, suppose the mechanical application of the back-to-back rules leads the CRA to deny a benefit Canada has agreed to extend to other country's residents in a bilateral treaty. In that case, the resources of the mutual agreement procedure (MAP) in the treaty or of the Canadian courts will be needlessly expended to restore the taxpayer to its treaty-protected position.[67]

In conclusion, the back-to-back withholding tax rules are mechanical and predictable. As such, the increased certainty would come at the expense of accommodating ordinary commercial arrangements with non-tax-avoidance purposes such as cash-pooling arrangements. Moreover, the back-to-back rules are objectively compared to the PPT of MLI and the LOB clause of the Canada- the US tax treaty. Therefore, the back-to-back withholding tax rules trigger a powerful anti-treaty shopping effect, even for bona fide commercial arrangements, and they are likely to be more effective than the kinds of anti-treaty shopping initiatives argue by the CRA *MIL (Investments) SA* (2007 FCA) and *Alta Energy*.

Conclusions

According to paragraph 212(1)(b) of the ITA, interest payments made or credited to non-residents are subject to the WHT at a rate of 25 percent if it is not "fully exempt" interest and is paid or payable in respect of a debt or other obligation to pay an amount to a non-arms length´s person. However, double tax treaties usually offer relief to the WHT applicable to interest payments to non-residents to 10 or 15 percent. Moreover, because of the broad exemptions under paragraph 212(1)(b), the only significant kind of interest requiring treaty relief is paid to non-arm's parties.

Provided that the only kind of interest requiring treaty relief is those paid to non-arm's parties and the Canada-U.S. relief interest payments to U.S. parent corporations, these differences would create opportunities for tax arbitrage such as treaty shopping arrangements. For instance, a parent of an MNE in a third country would seek to arrange lending transactions indirectly through the United States or other countries to qualify for tax treaty reliefs that would not otherwise be available on a direct loan from the ultimate lender or some other member of the international corporate group (i.e., back-to-back arrangements using a treaty jurisdiction).

66 Simplifying the Taxation of Inbound Investment, supra note 60.

67 *Ibid*.

The back-to-back arrangements generally involve interposing a non-resident financial intermediary (e.g., a foreign bank or possibly another group member resident in a jurisdiction with a "better" treaty with Canada than that would apply directly) located in a tax treaty jurisdiction between a Canadian taxpayer and a resident of a non-ta treaty jurisdiction to reduce the withholding tax that would apply if a loan were made and interest paid on loan directly.

In Canada, three regimes combat the treaty shopping schemes through back-to-back loan arrangements. First, the back-to-back loan rule in subsections 212(3.1) and 212(3.1), in a mechanical set of conditions, functions to deny treaty benefits (e.g., where both the immediate and ultimate funders are not dealing at arm's length with the Canadian taxpayer, and the immediate funder is entitled to a lower treaty-based rate of withholding tax than the ultimate funder). Second, the PPT of the MLI rule included in many of Canada's bilateral tax treaties is also a mechanism to address treaty shopping. Third, the Limitation on Benefits (LOB) provision of Article XXIXA of Canada– the US tax treaty.

Subsections 212(3.1) and 212(3.2) of the ITA provide specific objective rules to address back-to-back loan arrangements through treaty shopping schemes attuned to the common commercial characteristics of commercial lending transactions and the interests of genuine self-interested participants in them. In this vein, subsection 212(3.2) applies where a set of mechanical conditions are satisfied : (i) providing specific objective rules to address back-to-back loan arrangements where one or more "ultimate funders" (i.e., real lender) indirectly provide funding to a Canadian taxpayer through "relevant funding arrangements" involving one or more intermediaries, and; (ii) the causal connection tests in the back-to-back rules apply if a particular funding arrangement would be "reasonably be considered" to have been entered into because of another such arrangement.

For example, the back-to-back loan rules could catch cash-pooling arrangements upon the satisfaction of the causal connection test of clause 212(3.1)(c)(i)(B). In a notional cash-pooling arrangement, the members of a multinational group (including many nonresidents) deposit surplus cash with an arm's-length bank, which lends cash to other group members (including Canadian residents) to meet their operating needs.[68] Cash-pooling intra-group arrangements give significant commercial advantages, such as lower interest rates than those charged by arm's-length borrowers.

The most important provisions of the MLI are the preamble text of article 6(1) and the general anti-avoidance provision of the principal purpose test (PPT) of Article 7(1). All signatories have adopted both provisions to the MLI to satisfy the OECD's minimum standard on tax treaty abuse under BEPS action 6. Still, the PPT corresponds to a subjective test.

Under the domestic legislation, Canadian courts have reiterated that there is no general policy under the ITA against treaty shopping arrangements or most of Canada's tax

68 *Ibid*.

treaties (except for the LOB provision in the Canada-US Tax Treaty). For instance, *MIL Investments* and *Alta Energy* are involved in treaty shopping strategies using the Canada-Luxembourg tax treaty to benefit from the treaty exemption on capital gains tax under Article 13. Still, in both cases, the Minister unsuccessfully attempted to apply GAAR to said transactions. In *MIL Investment*, the courts rejected the minister's argument that an inherent anti-abuse rule would be read into the relevant tax treaty, despite the treaty containing no explicit provisions to counter treaty shopping. In addition, in *Alta Energy,* the SCC, at least, indicated in passing that those transactions, such as the one at issue in that case, could be considered differently in future under the MLI. Therefore, arrangements not previously caught by the GAAR under section 245 of the ITA would be captured by the anti-treaty shopping provisions in Articles 6 and 7 of the MLI. However, note that the back-to-back loan rules do not permit discretionary relief.

There is a criticism against the narrow approach of the back-to-back loan rules as an anti-treaty shopping mechanism because they do not permit discretionary relief. Since the PPT rule is included in many of Canada's bilateral tax treaties, it should be the mechanism by which Canada and those treaty partners have chosen to address treaty shopping.

In conclusion, the back-to-back withholding tax rules are mechanical and predictable. As such, the increased certainty would come at the expense of accommodating ordinary commercial arrangements with non-tax-avoidance purposes such as cash-pooling arrangements. Moreover, implementing the back-to-back rules is more objective than the PPT of the MLI and the LOB clause of Canada- the US tax treaty. Thus, the back-to-back withholding tax rules trigger a powerful anti-treaty shopping effect, even for bona fide commercial arrangements, and they are likely to be more effective than the kinds of anti-treaty shopping initiatives argue by the CRA *MIL (Investments) SA* (2007 FCA) and *Alta Energy*. Viewed this way, back-to-back loan rules would be considered an effective way to combat alleged "treaty shopping."

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