The Implications of the Supreme Court of Canada’s Decision in Alta Energy Luxembourg (2021) for the OECD Principal Purpose Test

In this article, the author demonstrates how the reasoning of the Supreme Court of Canada in the case of Alta Energy Luxembourg (2021) could influence the interpretation and application of the OECD Principal Purpose Test, resulting in an outcome more consistent with the protection of the rights of taxpayers.

1. Introduction

On 26 November 2021, the Supreme Court of Canada (SCC) gave its judgement in the case of Alta Energy Luxembourg (2021),2 dismissing the appeal of the tax authorities and granting the taxpayer the disputed benefits of Canada-Luxembourg Income and Capital Tax Treaty (1999).2 The facts of the case, as well as the different opinions of the SCC on that occasion, have been discussed already in the Bulletin for International Taxation.3 Alta Energy Luxembourg dealt with the participation of a Luxembourg entity in an international restructuring, which claimed an exemption from Canadian income tax as prescribed by the Canada-Luxembourg Income and Capital Tax Treaty (1999). The Canadian tax authorities, in their turn, denied this benefit on the ground that the transaction would have been abusive, frustrating the “object, spirit, and purpose” of the Canada-Luxembourg Income and Capital Tax Treaty (1999), resulting in the application of the Canadian domestic general anti-abuse rule (GAAR).4

Alta Energy Luxembourg primarily considered the interpretation and application of the Canadian GAAR. However, two further reasons demonstrate the relevance of the controversy and the arguments raised in the case to the interpretation and application of the OECD Principal Purpose Test (PPT) as set out in article 29(9) of the OECD Model (2017)5 and article 7(1) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the “Multilateral Instrument” or the MLI).6 First, the Canadian GAAR (as well its judicial application) and the PPT share some common features.7 Second, in Alta Energy Luxembourg, there was no controversy to the effect that the transaction was driven by tax reasons, as no relevant purpose for the intervention of the Luxembourg entity was provided, and neither was any other commercial activity performed in Luxembourg. In other words, the threshold that gives rise to the scrutiny of the transaction under the GAAR provision – the absence of bona fide reasons – was undoubtedly satisfied. Nevertheless, controversy remained on the application of the “objective element”, i.e. as to whether the concession of the benefit would have been in accordance with the object and purpose of the provision in question. This particular focus on the teleological approach of a GAAR is relevant, as it permits the academic debate to go further than the analysis of the subjective element of the PPT, the threshold in respect of which has been criticized for being too low,8 being even lower than the 2003 OECD guiding principle.9


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6. OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (7 June 2017), Annex I, as amended through 2012, Treaties & Models IBFD (hereinafter the Multilateral Instrument or the MLI).

7. As recently published in this journal: see Kandev & Lennard (2022), supra n. 3, at sec. 5.3.


2.1. The facts

Both parties, i.e. the taxpayer and the tax authorities, agreed on the facts of the case. The relevant factual element was the interposition of the Luxembourg entity, which was incorporated by the American controllers and fully owned Alta Canada. Approximately 18 months after the restructuring, Alta Luxembourg agreed to sell its shares of Alta Canada to Chevron Canada Ltd., a third-party company, realizing a capital gain. Alta Luxembourg directed the proceeds of the sale to Alta Energy Canada Partnership, offsetting debts contracted by the Luxembourg entity with the other entities of the group. Alta Luxembourg did not conduct any other business or investments following the disposal of its shares in Alta Canada.

2.2. The arguments advanced by the taxpayer and the tax authorities

2.2.1. The taxpayer

Alta Luxembourg claimed the exemption from Canadian income tax on the capital gain derived from the sale of the shares of Alta Canada under article 13 of the Canada-Luxembourg Income and Capital Tax Treaty (1999). Although the value of the shares sold was derived principally from immovable property situated in Canada, which would lead to a taxation at source according to article 13(4)(a) of the Canada-Luxembourg Income and Capital Tax Treaty (1999), the relevant provision included a carve-out from source-based capital gains that allocated the exclusive taxing right to the contracting state of the residence of the seller. This exception, also referred to as a “business property exemption”, prevents the contracting state in which the immovable property is located from imposing income tax upon the respective capital gains if the company whose shares were sold carries on business in such property. In Alta Energy Luxembourg, the source-based taxation prescribed by article 13(4)(a) Canada-Luxembourg Income and Capital Tax Treaty (1999) did not apply, being applicable to the residual rule of an exclusive residence taxation under article 13(5).

2.2.2. The tax authorities

The tax authorities conceded that Alta Luxembourg was a resident of Luxembourg for the purposes of the Canada-Luxembourg Income and Capital Tax Treaty (1999), as well as that a business had been carried on in the immovable property in question. Nevertheless, the exemption was denied on the ground that the restructuring, which occurred around 18 months before the sale, would have been abusive, as Alta Luxembourg did not have any economic connection with the Luxembourg jurisdiction and did not conduct any other business or investments there before or after the sale, leading to the application of the Canadian domestic GAAR.

2.3. The decision of the SCC

2.3.1. In general

Following the proceedings before the Tax Court of Canada (TCC) and the Canadian Federal Court of Appeal (CFCA), the tax authorities appealed to the SCC, arguing that the GAAR should apply to deny the exemption. According to the settled case law of the SCC, the three-step process to apply the Canadian GAAR analyses: (i) whether the transaction entails a tax benefit; (ii) the avoidance nature of the transaction, i.e. whether the transaction may reasonably be considered to have been undertaken or arranged primarily to obtain the tax benefit and not for bona fide purposes; and (iii) whether the transaction is abusive. Under the third step, the concept of abuse is crucial. Undertaking a factual analysis of the transaction, its abusive nature derives from the frustration of the “object, spirit, and purpose” of the provisions relied on for the tax benefit when interpreted as a whole. Accordingly, functioning as many other GAARs do, once a certain threshold (in Alta Energy Luxembourg, the absence of bona fide purposes other than the obtaining the tax benefit) is realized, the tax benefit may be denied if there is a divergence between the literal interpretation, on the one hand, and the application of the provision itself and its underlying object and purpose, on the other.

There was neither controversy that a tax benefit would be available as a result of the concession of the exemption (point (i) in the preceding paragraph) nor evident reason for the intervention of a Luxembourg company in the restructuring in addition to the application of the Canada-Luxembourg Income and Capital Tax Treaty (1999) (point (ii) in the preceding paragraph). Consequently, the question considered by the SCC related to the abusive nature of the transaction (point (iii) in the preceding paragraph), i.e. whether it would have frustrated the “object, spirit, and purpose” of the provisions relied on for the tax benefit when interpreted as a whole.

2.3.2. The majority opinion in the SCC decision

In order to assess the “object, spirit, and purpose of the provisions”, the majority opinion in the SCC decision referred to the intention of the drafters to justify an approach that

10. TCC, Alta Energy Luxembourg (2018), supra n. 1, Appendix A.
12. Id., at para. 317.
13. According to Kandev & Lennard (2022), supra n. 3, at sec. 3.1, the Canadian tax authorities initially challenged that a business had effectively been carried on in that property. However, this argument has not been advanced in the appeals of the tax authorities.
14. See TCC, Alta Energy Luxembourg (2018), supra n. 1 and CFCA, Alta Energy Luxembourg (2020), supra n. 1. For a description of the whole procedure, see Kandev & Lennard (2022), supra n. 3, at secs. 3.2 and 3.3.
16. See, for example, DE: Abgabenordnung, 2007, §42 and AT: Bundesabgabenordnung, 2018, §22. In both cases, there is reference to purpose of the circumvented or captured provision.
was more consistent of the wording of the dispositions taken as a whole. The majority opinion denied the appeal of the tax authorities on the ground that the tax authorities had failed to demonstrate unequivocally the abusiveness of the transaction, i.e. that the participation of the Luxembourg entity in the transaction would have frustrated the “object, spirit, and purpose of the provisions” in the Canada-Luxembourg Income and Capital Tax Treaty (1999).\(^{18}\) Moreover, the majority opinion stated that a GAAR could not be used to amend or renegotiate a tax treaty unilaterally.\(^{19}\)

In short, the majority opinion relied on the absence of rules with the subject-to-tax or look-through approaches, as the drafters adopted only the exclusion approach regarding some Luxembourg holdings, as well as on the underlying purpose of the carve-out to attract investments. Both considerations prevented the majority opinion from qualifying the transaction, although driven by tax avoidance purposes, as abusive.\(^{20}\) Accordingly, the SCC dismissed the appeal of the tax authorities, refusing to amend the tax treaty to prescribe an ad hoc requirement of substantive economic connections to the state of residence to access the treaty benefits in general so as to be granted with the exemption in article 13(4) and (5) of the Canada-Luxembourg Income and Capital Tax Treaty (1999) specifically.

2.3.3. The dissenting opinion in the SCC decision

The dissenting opinion in the SCC decision, in its turn, diverged mainly on the evaluation of the “object, spirit, and purpose” of the relevant provisions as assessed by the majority decision. Based on the premise that a GAAR could only apply where a taxpayer has complied literally with the strict requirements of the relevant provision,\(^ {21}\) the dissenting opinion dismissed the attachment to the literality of the tax treaty proposed by the majority.\(^ {22}\)

Under this reasoning, the dissenting opinion stated that the “object, spirit, and purpose” of a tax treaty as a whole is “to assign taxing rights to the state with the closest economic connection to the taxpayer’s income”.\(^ {23}\) Accordingly, the so-called theory of economic allegiance would ground the delimitation of the subjective scope of a tax treaty to residents of either contracting state, as they would be the persons with an economic allegiance to one or both jurisdictions.\(^ {24}\)

The assignment of taxing rights to the state with the closest connection to taxpayer’s income was also identified by the dissenting opinion as the underlying purpose of the carve-out set out in article 13(4) of the Canada-Luxembourg Income and Capital Tax Treaty (1999). In this sense, the fact that a business was carried on by the company whose shares were sold would imply that the taxpayer (seller) derived more benefits from the state of residence than from the state in which the infrastructure is located.\(^ {25}\) Consequently, the lack of “genuine economic connection with Luxembourg” would have defeated the “object, spirit, and purpose” of the provisions that assigned exclusive taxing rights to Luxembourg in that case.\(^ {26}\) Moreover, it would also have defeated the general objective of encouraging trade and investment underlying the carve-out. According to the dissenting opinion, there had not been an acquisition or an investment in Canada but, rather, the liquidation of an existing investment in Canada without paying taxes on the respective capital gain.\(^ {27}\) In conclusion, the dissenting opinion regarded the transaction as abusive, and, therefore, denied the claimed exemption from Canadian income tax on the capital gain derived by Alta Luxembourg.

3. Alta Energy Luxembourg and the OECD PPT

3.1. The objective element: “the object and purpose of the relevant provisions of this Convention”

3.1.1. Opening comments

The majority and the dissenting opinions highlight two different approaches when it comes to the objective element of a GAAR (see sections 2.3.2. and 2.3.3.). This analysis is particularly relevant due to the central role played by the teleological element in the functioning of a GAAR. Such an anti-abuse measure, either domestic or international, deals inevitably with a mismatch between the object and purpose of a provision and its wording. Being realized by a prescribed threshold (in the Canadian case, the elusive character of a transaction that lacks non-tax reasons), the GAAR addresses the following conflict – although the relevant provision is textually applicable (in the case of a tax benefit rule) or not applicable (in case of a tax incidence rule), such an application or a non-application defeats the object and purpose of the provision.\(^ {28}\) This state of affairs clearly goes beyond the wording of the provision, resulting in effects of teleological reduction or analogy, respectively. This position is why the application of a GAAR entails a step further the legal interpretation (Rechtsauslegung) of the relevant provisions to an extension of the law-making process (Rechtsfortbildung). The main difference between both methodologies lies in the constraint to the possible meaning of the wording, on the one hand, and the development of the rule beyond it, on the other.\(^ {29}\)

This reasoning was quite clear in both the majority and the dissenting opinions. The Canadian tax authorities did not even challenge the facts that: (i) Alta Luxembourg was resident in Luxembourg for tax purposes according to the local legislation; and (ii) a business was effectively carried on in the immovable property. From a literal approach, the

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18. SCC, Alta Energy Luxembourg (2021), supra n. 1, at para. 93.
20. Id., at para 85.
22. Id., at paras. 103 and 116.
23. Id., at para 104.
24. Id., at para 152.
25. Id., at paras. 104, 157 and 164.
26. Id., at para 179.
27. Id., at para 173.
28. See Schön, supra n. 18.
29. See K. Larenz & C-H. Canaris, Methodenlehre der Rechtswissenschaft 3rd edn., p. 187 (Spring Verlag 1995). This theoretical referral has also been applied specifically to the PPT in the literature. See R.J. Danon, The PPT in Post-BEPS Tax Treaty Law: It Is a GAAR but Just a GAAR!, 74 Bull. Intl. Taxn. 4/5, sec. 3.3.3. (2020), Journal Articles & Opinion Pieces IBFD.
taxpayer complied with the requirements for the exemption. Conversely, the question in debate before the SCC was the possibility of a teleological reduction in the relevant treaty-based exemption rule so as to prescribe additional (and it could be said ad hoc) requirements to access such benefit, taking into account the object and purpose of the relevant provisions.

The majority opinion concluded that the object and purpose of the carve-out was to foster the development of active businesses in immovable properties located in Canada, which was substantively and effectively achieved by the taxpayer’s investment. Based on this reasoning, the majority opinion dismissed any mismatch between the compliance with the literal requirements of the tax treaty and the underlying purpose of the provisions.

Conversely, the dissenting opinion concluded that the object and purpose of the tax treaty as a whole and the specific provisions was the assignment of taxing rights to the state whose jurisdiction is the closest to the taxpayer’s income, as well as to attract new investments to Canada. Then, although Alta Luxembourg had complied with the literal requirements of the treaty-based exemption, the underlying purpose of the provisions would have been defeated, leading to the denial of the benefit. Here, it was exactly the point where the dissenting opinion proceeded to the teleological reduction of the rule. Although observed all literal requirements, it developed new requirements (genuine economic connection with the state of residence and acquisition of new investments), which narrowed the scope of application of the exemption, excluding the taxpayer from it.

These considerations may also apply to the PPT as developed by the OECD. Being realized by way of the threshold of the subjective element (obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit), it should be assessed whether granting the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions. Especially considering how low the threshold of the subjective element is, the assessment of the objective element (the core of the GAAR) is even more relevant in the PPT. The question, therefore, as in Alta Energy Luxembourg, is to establish the object and purpose of the relevant provisions and, more importantly, the criteria to impose additional (and ad hoc) requirements to access to the treaty benefits.

3.1.2. The search for criteria for the teleological reduction of treaty rules

There are two main differences between the reasoning adopted by the majority and the dissenting opinions regarding the teleological approach to the relevant provisions of the Canada-Luxembourg Income and Capital Tax Treaty (1999). The dissenting opinion referred more to the purpose of the tax treaty and the rationale underlying the relevant provisions of the tax treaty. Second, the majority opinion seemed to analyse specifically the purpose of the relevant provisions, while the dissenting opinion identified a purpose that underlined the entire Canada-Luxembourg Income and Capital Tax Treaty (1999), and tried to explain the rationale of the relevant dispositions from such general purpose.

With regard to the first difference, which constitutes a preliminary premise to be established before the assessment of the object and purpose of the relevant provisions, the reference to the intention of the treaty negotiators should be reconsidered. Every tax treaty is a result of very particular negotiation circumstances. Such a situation does not mean, however, that the search of the object purpose is an inquiry as to the subjective state of mind of its drafters. This debate in legal theory is even wider than the discipline of tax treaties, and comprises the controversy between a subjective (voluntas legislatoris) and an objective (voluntas legis) purposive approach to legal statutes.

Under the subjective approach, it would be possible to search for the purpose of the drafters not only in the materials of the negotiation, but also in the factual context of the negotiation, the political environment the negotiators were in, etc. Nevertheless, there are at least two flaws in this approach. First, the image of the negotiators is nothing but a fiction created by those interpreting the provisions. This situation is especially so, as it is impossible to individualize the purpose of the negotiators because the tax treaty in question is the result of a confluence of a number of factors, not to say the legislative approval by the parliaments of both of the contracting states. Second, the authority of a tax treaty, as a result of the negotiations duly approved following constitutional-based procedures, is derived from its text, in the sense that any non-textual element lacks the authority to bind its parts. The subjective approach inverts the interpretative process. Instead of searching the purpose from the text of a tax treaty itself, in a systematic analysis of its provisions, the subjective approach aims to construe the meaning of the text of the tax treaty in question from the contextual aspects that surrounded its negotiators. In broader terms, it is very difficult to argue that even the subjective intention of the drafters is somehow different from the enunciation of the text itself. Put simply, the negotiators intended what the text means. These reflections lead to the conclusion that the object and purpose of a tax treaty should be construed specifically from its relevant provisions, avoiding general considerations, and primarily when disconnected from the wording of the provisions taken systematically.

33. K. Hosseinnejad, Interpretation in Light of Which “Object and Purpose”?, in German Yearbook of International Law, p. 385 (Duncker & Humblot 2018).
according to the second point of divergence between the majority and the dissenting opinions.

This position is consistent for two main reasons. First, the primary source for this search for the underlying purpose is the wording of the provisions considered systematically. Second, one tax treaty may pursue multiple objectives for different purposes, which may be sometimes even contradictory.34

Focusing on the relevant provisions, articles 1 and 4(1) of the Canada-Luxembourg Income and Capital Tax Treaty (1999), which deal with the subjective scope of the tax treaty, together with article 13(4) and (5) of the tax treaty, should be analysed further to identify the underlying purpose of the provisions. In general, it is very difficult to follow the reasoning of the dissenting opinion to the effect that the theory of economic allegiance would play any role in the object and purpose of the tax treaty as a whole or of the specific provisions in particular. Given the high level of vagueness of the concept, such a theory also implies that one state would have stronger taxing rights than the other state in taxing a determined item of income. In other words, the taxation of a certain item income in one state would be more consistent with international standards than in the other. Such premises are far from unanimous, and do not explain the wide recognition that the avoidance of double taxation, although recommendable, does not constitute an international obligation because there is no international rule of precedence between the taxing rights of the states of residence and source.35

When it comes to the definition (and delimitation) of the subjective scope, this theory is more problematic. Even if it is accepted that access to the treaty benefit is dependent on the genuine connection of the taxpayer to the state of residence, it would be very difficult to ascertain precisely how much connection would be required, and, more importantly, under what criteria such a connection should be assessed. In fact, the dissenting opinion did not specify exactly the elements that should have been present for the benefits of the Canada-Luxembourg Income and Capital Tax Treaty (1999) to be granted. Neither did the text of the Canada-Luxembourg Income and Capital Tax Treaty (1999) itself provide them. Conversely, the Canada-Luxembourg Income and Capital Tax Treaty (1999) is silent on any additional requirements for the tax benefits entitlement, prescribing only the exclusion of certain species of Luxembourg holdings from the tax benefits.

The majority opinion applied the argument a contrario (referred to as an “implied exclusion doctrine”). According to this argument, as the Canada-Luxembourg Income and Capital Tax Treaty (1999) was silent to impose additional requirements to the entitlement of the benefits of the tax treaty, it should be deemed to be an “eloquent silence” in the sense of allowing the concession of the benefit in every situation other than those expressly forbidden by the tax treaty.

The main difficulty in following the approach proposed by the dissenting opinion is the arbitrariness it may result in. The lack of textual elements that makes it possible to conclude how to access the “genuineness” of a connection to one of the contracting states, as well as to determine how much genuine connection a tax treaty requires, would effectively result in the ad hoc amendment of the tax treaty by the tax authorities or the courts. Conversely, neither could a purposive approach to the relevant provisions lead to this conclusion. The object and purpose of articles 1 and 4(1) of the Canada-Luxembourg Income and Capital Tax Treaty (1999) are connected strongly to the common definition of the term “a person resident in one or both of the Contracting States” for the relevant treaty provisions to be operative. This definition clearly refers to the domestic legislation of the contracting states, as long as they define their residents under subjective – and internationally adopted – criteria such as “that person’s domicile, residence, place of management or any other criterion of a similar nature”. As correctly stated by the majority opinion, the criterion adopted by the Luxembourg legislation – the place of incorporation –, although formal, is internationally accepted.

The absence of any specific rule dealing with this situation other than the exclusion of certain Luxembourg holdings beneficiaries of preferential tax regime, although not definitive, provides a relevant argument in favour of the taxpayer. The object and purpose of the relevant provisions of the Canada-Luxembourg Income and Capital Tax Treaty (1999) do not appear to be defeated by the concession of the treaty benefits to a Luxembourg entity subject to low taxation there, as long as it does not qualify as such excluded holdings. This reasoning does not mean that the mere satisfaction of the literal requirements of the claimed exemption is sufficient to dismiss any abusive nature. Concluding so would deprive the GAAR from any relevance, as its application only occurs if there is a divergence between the compliance with literal requirements and the object and purpose of the provisions in question.

The search for criteria to the teleological reduction that the GAAR entails is based on the text of the tax treaty under analysis. In other words, the GAAR leads to the following question. Were the requirements and conditions for the concession of the benefit substantively and effectively complied with by the taxpayer? Instead of searching those requirements and conditions in vague concepts, such as the genuine connection, the textual dispositions should be analysed and, from this analysis, the object and purpose of the relevant provisions should be construed. In undertaking this task, the equivalent of article 13 is more relevant than articles 1 and 4(1). Specifically, while the latter are merely operative dispositions, the former effectively presents, as its object, the assignment of taxing rights between the contracting states.

In this sense, it is difficult to follow the reasoning of the dissenting opinion to the effect that the carve-out in article 13(4) of the Canada-Luxembourg Income

34. Id., at pp. 383 and 384.
and Capital Tax Treaty (1999) aims at the same general purpose of the tax treaty as a whole so as to assign taxing rights to the state with closest connection to the item of income in question. In fact, the carve-out appears to be an exception to the underlying rationale of article 13 of the Canada-Luxembourg Income and Capital Tax Treaty (1999). Despite the value of the shares sold being derived principally from immovable property situated in Canada, whose taxing rights would be consistent to the situs principle that guides article 13(1) and (4) of the Canada-Luxembourg Income and Capital Tax Treaty (1999), the tax treaty prevented Canada from taxing the capital gain, as long as a business was carried on in such property. Why was the situs principle set aside under these conditions? Relevantly, the exception would only apply if such a business was not the mere rental of the property. Moreover, why would capital gains derived from the sale of shares of a company that carried on rental of immovable properties in Canada be taxed there, while the same transaction, but with a company that carried on business such as mining or running a hotel, would not? It should not be forgotten that, ultimately, both capital gains derived mainly from immovable properties located in the other state.

At this point, it seems to be clear that the carve-out, due to its exceptional nature, was product of a very specific negotiation between the contracting states. The object of such provision was to rule out some capital gains from the underlying rationale of the situs principle, while its purpose was to attract business other than those related to the simple rental of immovable properties.

From this perspective, i.e. a text-based search for the criteria to apply the purposive approach to the relevant provisions, the questions to be answered differ from those raised by tax authorities in Alta Energy Luxembourg. The first question is whether the company whose shares were sold substantively and effectively carried on a business in the immovable property other than the mere rental. The second question is whether there has been, substantively and effectively, the sale of the shares with regard to the assessment of the relevant capital gain. (This question is a general requirement for the application of article 13 of the Canada-Luxembourg Income and Capital Tax Treaty (1999).) A third question can be conceived, i.e. whether the taxpayer is substantively and effectively an entity other than a Luxembourg holding company that is excluded from the substantive scope of the Canada-Luxembourg Income and Capital Tax Treaty (1999). This third question would be more difficult for tax authorities to challenge, as the criterion for the exclusion approach adopted by the Canada-Luxembourg Income and Capital Tax Treaty (1999) was primarily a formal one.

Nevertheless, more importantly, none of those questions were raised by the Canadian tax authorities in Alta Energy Luxembourg. Their absence in justifying the denial of the exemption leads to two conclusions. These conclusions were: (i) the criteria on which the denial of the exemption was based were disconnected from the text of the Canada-Luxembourg Income and Capital Tax Treaty (1999); and (ii) in doing so, the tax authorities failed to discharge their burden of establishing that the avoidance transaction was abusive in defeating the object and purpose of the relevant provisions.

3.1.3. The burden to establish the (non-)abusive nature of the transaction

The decision of the SCC also sheds light on another relevant element of the application of GAAR – on whom the burden to establish the abusive nature of a transaction falls. This question is of utmost importance when it comes to the PPT, as the teleological element of the clause is stated in article 29(9) of the OECD Model (2017) as being:

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

Although this conclusion is not expressly supported by the wording of the last part of the PPT, the Commentary on Article 29 of the OECD Model (2017) states that a treaty benefit might be denied “where one of the principal purposes of an arrangement or transaction that has been entered into is to obtain a benefit under the convention”.38 In this case, the burden to demonstrate the absence of abuse, i.e. accordance between the concession of the benefit in such conditions and the object and purpose of the relevant provisions, would fall on the person to whom the benefit was denied. This conclusion might be supported by the fact that, as written, the objective element of the PPT would constitute an exception to the rule that denies the benefit if one of the principal purposes of a transaction was to obtain such a benefit.39 Some authors have accepted this conclusion, although with some slight nuances.38

From a logical perspective, it could be argued that the employment of the expression “unless” does not result in the possibility of application of the rule uniquely from the statement that one of the principal purposes of a transaction was to obtain some treaty benefit. The provision can be construed as follows:

– if:
– it is reasonable to conclude that one of the principal purposes of the transaction was to obtain some treaty benefit; and
– the concession of such a benefit in those circumstances was contrary to the object and purpose of the relevant provision;

– then the benefit should be denied.

The subjective and objective elements of the legal hypothesis are undissociated parts of one legal statement for at least three reasons (although it is possible to split them

38. See, for example, V. Chand, The principal purpose test in the Multilateral Convention: an in-depth analysis, 46 InterTax 1, p. 21 (2018); S. van Weeghel, A Deconstruction of the Principal Purposes Test, 11 World Tax J. 1, sec. 4 (2019), Journal Articles & Opinion Pieces IBFD; and Schön, supra n. 18, at p. 19.
for analytical purposes). First, despite the fact that the term “unless” might imply some sense of exception, the PPT as a whole is an exception to the benefit granting provisions that would otherwise apply. Second, as noted in section 3.1.1., the application of a GAAR depends on the divergence between the literal compliance with the textual requirements of a provision and the defeat of its object and purpose. In other words, if such a divergence is not established, there is no room for the application of a GAAR, such as the PPT. The subjective element is only the threshold that triggers the purposive approach that could result in the teleological reduction of the relevant treaty disposition. In the absence of such a demonstration, the PPT would apply comprehensively, as the treaty benefits were negotiated primarily to determine the behaviour of economic agents, in the sense that virtually all transactions that fall under the scope of a treaty benefit could have it as at least one of their principal purposes. This result would be contrary to the principle of effectiveness that guides the interpretation of treaties. Third, as long as the tax authorities base the denial of the treaty benefit on the GAAR, the burden to demonstrate that both elements of the legal hypothesis of the rule are fully satisfied lies with the tax authorities.

With special regard to the third argument noted in the preceding paragraph, an opposite conclusion would entail a disproportional restriction to the principle of the observance of the rights of defence, as construed by the Court of Justice of the European Union (ECJ), or to the principle of due process law, as derived from US constitutionalism. As the objective element is an essential part of the legal hypothesis under which the facts of the case should be subsumed for the GAAR to apply, such a subsumption is a matter of the utmost relevance to a taxpayer’s defence. However, if the tax authorities did not bear the burden of establishing that the granting of treaty benefits in those circumstances would be contrary to the object and purpose of the relevant provisions, the taxpayer would be deprived of an effective defence against the denial of the benefit, simply because reasons on which the administration’s decision was based would be unclear.

At the end of section 3.1.2., a number of questions that could have been raised by tax authorities in *Alta Energy Luxembourg*, but were not advanced to deny the treaty benefits were conceived. Had the SCC not assigned the burden of demonstrating the abusive nature of the transaction to tax authorities, the taxpayer would be unable to formulate properly its defence, as it would not have been clear against what accusations it would have to argue. If the Canadian tax authorities had denied the benefit exclusively on the ground of the absence of non-tax purposes of the transaction, such a denial would be missing an essential element of the accusation of abuse. Against what would have the taxpayer to defend itself? The lack of genuine economic connections to the Luxembourg jurisdiction? The low taxation of such capital gains in Luxembourg? The absence of a new investment in Canada relating to business carried on in immovable properties? The closer connection of the capital gain to Canada than to Luxembourg? As can be clearly seen, if the accusation is not sufficiently delimited by the tax authorities at the very first moment of the denial of the benefit, the defence becomes an unattainable effort to the taxpayer, as the grounds on which the accusation was based could also vary, as the taxpayer formulates one specific defensive argument.

### 3.2. The subjective element and the relevance of the benefit

A final word needs to be said regarding the subjective element and the relevance of the concept of benefit. Among the arguments raised in the dissenting opinion, one of the most traditional statements against treaty shopping was delivered, i.e.:

> the common intention of Canada and Luxembourg could not have been to provide an avenue for residents of third-party states to indirectly obtain tax benefits they could not obtain directly absent any real economic connection with Luxembourg.

With regard to the PPT, not only is it relevant that there is a benefit, but also that seeking that benefit was one of the principal purposes of an arrangement or transaction. In other words, such a benefit must be relevant enough to qualify itself as one of the reasons that objectively motivated the settlement of the arrangement or transaction. From this perspective, the PPT could only find room if the treaty-based benefit implied an effective reduction of the comprehensive tax burden of the transaction, considering all of the jurisdictions involved. This is crucial, as, at first sight, one state may qualify any reduction of its taxation as a benefit. Nevertheless, in many cases, the reduction or suppression of taxation at source, for example, only results in a reduction in the tax credit to be granted by the state of residence. Would it constitute a benefit the obtaining of which could be concluded reasonably as one of the principal purposes of an arrangement or transaction? It is difficult to agree with this one-state-perspective concept of a benefit in the context of the PPT, as the arrangement or transaction might have not brought any advantage at all.

The capital gain derived by Alta Luxembourg was subject to low taxation in its state of residence. This circumstance could be clear enough to demonstrate that the treaty-based exemption in Canada could have resulted in a tax advantage with regard to the transaction. Nevertheless, as the extract of the dissenting opinion referred to at the beginning of this section demonstrates, the abusive nature of the transaction could have been based on the fact that the Canada-Luxembourg Income and Capital Tax Treaty (1999) could have been used by residents of third countries – in this case, in the United States – to extrapolate its bilateral nature. For this argument to be
consistent minimally, however, it would be necessary to assess the entire tax burden on the operation considered as a whole. In this sense, it should be recalled that the taxpayer was a subsidiary of a Canadian partnership whose partner was a Delaware limited liability company (LLC), which was controlled by two US corporations, in turn. Assessing the tax burden as a whole, it would be inevitably necessary to evaluate how (and when) the profits derived by Alta Luxembourg from the capital gain would be taxed in the hands of the Canadian partnership (if so) or even by the US controlling companies. In order to illustrate this aspect, hypothetical US controlled foreign corporation (CFC) legislation that could encompass the profits earned by CFCs would simply eliminate any effective advantage if the scenarios ante- and post-restructuring were compared.

Such an evaluation is even more relevant in the context of the PPT, where the threshold of the subjective element was considerably lowered compared to other purpose-based GAARs (such as the Canadian GAAR), even with the OECD guiding principle. Given these circumstances, the reduction in taxation granted by the Canada-Luxembourg Income and Capital Tax Treaty (1999) must imply an effectively favourable outcome to the global burden of the transaction taken as a whole. The mere transfer of taxing rights from one state to another, although it could result in a minor timing advantage, could hardly be considered to be one of the principal purposes of the transaction under analysis.

4. Conclusions

The SCC’s decision in Alta Energy Luxembourg contributes considerably to the proper interpretation of the PPT and its application, even though the case involved the Canadian GAAR. The particular focus given to the purposive approach in ascertaining the abusive nature of the transaction in question, as well as to whom the burden of demonstrating this state of affairs should fall, may also have a significant effect on the PPT.

As demonstrated in this article, the PPT — as is also the case with many domestic GAARs — clearly goes beyond the wording of the provision, resulting in a teleological reduction. In other words, once the PPT threshold has been satisfied, the question arises as to whether there is a divergence between literal compliance with the requirements in respect of the treaty-based benefits and the object and purpose of the relevant provisions. This circumstance was quite clear in Alta Energy Luxembourg. From a literal perspective, the taxpayer complied with the requirements for the exemption. Accordingly, the question before the SCC was the possibility for a teleological reduction in the relevant treaty-based exemption rule so as to prescribe additional requirements for accessing such a benefit, taking into consideration the object and purpose of the relevant provisions.

Instead of vague and non-text-based concepts, such as the “genuineness” of a connection to one of the contracting states, the search for criteria to the teleological reduction that the GAAR entails has its cornerstone in the text of the Canada-Luxembourg Income and Capital Tax Treaty (1999). From this perspective, i.e. a text-based search for the criteria for the application of the purposive approach to the relevant provisions, the questions to be answered should assess whether the requirements for the concession of the treaty-based benefits were substantively and effectively satisfied by the taxpayer, and not just in a merely formal manner. Taking Alta Energy Luxembourg as an example, the three relevant questions — which were not raised by the tax authorities — that should have been asked are whether: (i) the company whose shares were sold substantively and effectively carried on business in the immovable property, rather than merely renting it; (ii) there was substantively and effectively the sale of such shares, thereby resulting on the assessment of the relevant capital gain; and (iii) the taxpayer was substantively and effectively an entity other than a Luxembourg holding company that was excluded from the substantive scope of the Canada-Luxembourg Income and Capital Tax Treaty (1999).

As the tax authorities failed to challenge the transaction on the ground of the effective and substantive satisfaction of the requirements provided by the Canada-Luxembourg Income and Capital Tax Treaty (1999), they also failed to discharge themselves from the burden of establishing that the avoidance transaction was abusive by defeating the object and purpose of the relevant provisions. This conclusion of the SCC is very relevant in the context of the PPT, otherwise it would be possible to argue that, due to the word “unless” that introduces the objective element of the clause, the taxpayer would have the burden of establishing the convergence between the granting of the benefit and the object and purpose of the relevant provisions. This conclusion, however, is wrong. Not only does it lack support of the express wording of the clause, but also it would disproportionately restrict the rights of defence of the taxpayer. If the tax authorities do not delimit the accusation on the first denial of the benefit, a taxpayer’s defence is unsustainable, as the grounds of the accusation may also vary as the taxpayer formulates a specific defensive argument.

Finally, when it comes to the subjective element, especially considering the low threshold established by the PPT, it is very difficult to agree with this one-state perspective concept of a benefit in the context of the PPT, as the arrangement or transaction might not have any actual advantage. This state of affairs is why the assessment of whether the obtaining of a certain treaty-based benefit would have constituted one of the principal purposes of a transaction should take into account the effect of such a benefit in relation to the global tax burden. After all, the mere transfer of taxing rights from one state to another, although it may result in a minor timing advantage, could hardly be considered to be one of the principal purposes of the transaction in question.