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tax bulletin

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federal court of appeal upholds favourable judgment on the tax treatment of cross-border investments

Non-residents frequently invest in Canada through foreign intermediaries. A key consideration in structuring such investments is whether the intermediary will be subject to reduced rates of Canadian withholding tax in respect of payments received from Canadian parties.

An intermediary resident in a jurisdiction with which Canada has an income tax treaty may be entitled to claim the benefits afforded by the treaty, including reduced rates of withholding tax on various types of payments. In most instances, the entitlement to claim treaty-reduced rates of withholding tax is dependent on the foreign entity being the "beneficial owner" of the subject payments.

The Canadian government has recently challenged the characterization of certain foreign entities as the "beneficial owner" of payments received from Canadian companies where there is an indication that equivalent amounts are being paid by the foreign recipient to persons resident in other jurisdictions.

The attempts of the Canadian government to challenge the tax treatment of such foreign holding structures were dealt a serious blow when, on February 26, 2009, the Federal Court of Appeal (the "FCA") upheld the decision of the Tax Court of Canada in the case of *The Queen v. Prévost Car Inc.* ("*Prévost Car*"). In *Prévost Car*, the Court was called upon to consider the meaning of the term "beneficial owner" in the context of the *Canada-Netherlands Income Tax Convention* (the "Treaty").

the facts

The central matter in dispute in *Prévost Car* related to the withholding tax rate that was applicable to dividends paid by Prévost Car Inc. ("Prévost"), a corporation resident in Canada, to its sole shareholder, Prévost Holding B.V. ("Prévost Holding"), a corporation resident in the Netherlands. Following the receipt of dividends from Prévost, Prévost Holding paid dividends in substantially the same amount to its corporate shareholders, Volvo Bussar Corporation ("Volvo"), a company resident in Sweden, and Henlys Group PLC ("Henlys"), a company resident in the United Kingdom.

Prévost withheld and remitted non-resident withholding tax on dividends paid to Prévost Holding at a treaty reduced rate of 5%, relying on Article 10 of the Treaty. To claim the reduced rate of withholding tax under the Treaty, the "beneficial owner" of the dividends had to be a company that, directly or indirectly, held at least 25% of the capital, or at least 10% of the voting power, of Prévost.

The Minister of National Revenue (the "Minister") assessed Prévost for additional tax payable under Part XIII of the *Income Tax Act* (Canada) (the "Tax Act") and asserted that the reduced rate of withholding provided under the Treaty did not apply because the "beneficial owner" of the dividends paid by Prévost was not Prévost Holding. Instead, the Minister assessed Prévost on the basis that Volvo and Henlys were the "beneficial owners" of a portion of each of the dividends paid by Prévost.

tax court of canada decision

The Tax Court held that the resolution of the matter in dispute in *Prévost Car* was dependent on the meaning of the words "beneficial owner" (and the French and Dutch equivalents) appearing in Article 10(2) of the Treaty. After determining that the relevant terms were not defined in the 1977 OECD model convention, the Treaty, or the Tax Act, the Court concluded that "the "beneficial owner" of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received". On that basis, the Tax Court held that Volvo and Henlys were not the "beneficial owners" of the dividends paid by Prévost and, consequently, Prévost's appeal was allowed.

federal court of appeal decision

In appealing the decision of the Tax Court to the FCA, the Minister claimed that the Tax Court gave the term "beneficial owner" the meaning it has at common law, thereby ignoring the meaning it has in civil and international law. The FCA was quick to reject the Minister's appeal on the basis that the Tax Court had closely and properly analyzed the ordinary and technical meanings of the term "beneficial owner", along with the meaning the term may have (i) at common law, (ii) in the Québec civil code, (iii) in Dutch law and (iv) under international law.

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The FCA's decision in *Prévost Car* may bolster the confidence of non-resident investors who wish to structure investments in Canada through intermediary entities. It remains to be seen whether the Minister will seek leave to appeal the judgment of the FCA to the Supreme Court of Canada.

For more information, contact David Wentzell (416.865.7036 | david.wentzell@mcmillan.ca) in Toronto or Andrew Etcovitch (514.987.5064 | andrew.etcovitch@mcmillan.ca) in Montreal or any other member of McMillan's Tax Group.