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SPECIAL REPORTS

Canada-U.S. Tax Treaty Issues: Anti-Hybrid Rules, The GAAR, and the U.S. Dual Consolidated Loss Rules

by Matias Milet and Peter Repetto

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The fifth protocol to the Canada-U.S. tax treaty[1] introduced anti-hybrid rules (in Articles IV(7)(a) and (b) of the treaty), which, when applicable, deny treaty benefits on amounts derived through or received from hybrid entities by residents of either treaty country after December 31, 2009. These rules prevent the benefits of the treaty, such as reductions to withholding tax rates and capital gains tax exemptions, from applying to many common cross-border investment structures. The rule that arises most frequently in practice in Canada is the one in Article IV(7)(b), which denies treaty benefits to payments from Canadian resident ''hybrid'' entities (that is, entities that are not fiscally transparent in Canada, but are fiscally transparent in the U.S.) to U.S. residents in some circumstances.

The Canada Revenue Agency has in several published administrative statements accepted that some ''workaround'' transactions are effective for avoiding the application of Article IV(7)(b) to deductible payments (such as interest and royalties)[2] made by a Canadian resident hybrid entity to related parties in the U.S. However, the CRA has stated that while such transactions may succeed in avoiding Article IV(7)(b) from a technical standpoint, the CRA may nevertheless apply the Canadian general antiavoidance rule to deny treaty benefits in some circumstances when Article IV(7)(b) has been avoided. Until recently, taxpayers and their advisers were left largely in the dark as to what those circumstances might be. A fall 2010 American Bar Association panel discussion, as well as a recently published CRA administrative ruling, however, provide an indication of some factors the CRA might take into account in determining whether to apply the GAAR to a particular Article IV(7)(b) workaround transaction. Although perhaps offered more as an indication of a possible direction in which administrative policy might develop than as markers of any settled position, these CRA statements suggest that the CRA may consider taking into account certain facts relating to U.S. tax reduction in determining whether the GAAR applies to such workaround transactions. In particular, the CRA seems to have countenanced the possibility that the application of the U.S. dual consolidated loss (DCL) rules may be relevant to the GAAR determination.

The possibility that the DCL rules may be relevant in this context would seem to open the door to a jurisdictional hall of mirrors, as it were, in which the application of a Canadian domestic antiavoidance rule to a potential abuse of a treaty antiavoidance rule (Article IV(7)(b)) may depend, in part, on the application of a U.S. antiavoidance regime (the DCL rules), which in turn depends for its application on the use made under the income tax laws of Canada of some deductions or losses. This deployment of non-Canadian tax considerations in applying the GAAR would be surprising insofar as it seems to make foreign tax avoidance relevant to the application of a domestic antiavoidance rule. It would also arguably be at odds with the CRA's relatively circumscribed focus in applying Article IV(7)(b) on the immediate U.S. treatment of the income item being taxed by Canada (for example, the

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[1] The fifth protocol entered into force on December 15, 2008.

[2] Article IV(7)(b) can potentially apply not only to deductible payments but also to dividend payments, gains, and payments that form part of business profits of a resident of one of the two contracting states.

interest or royalty payments received by the U.S. resident from the Canadian hybrid entity), rather than on how that income item interacts with secondary features of the U.S. tax system (such as foreign tax credits) that do not affect how the item of income is treated under U.S. law in the first instance. This article reviews the recent public statements mentioning the DCL rules in conjunction with Article IV(7)(b) and GAAR and considers their broader implications for Article IV(7)(b) workaround transactions involving deductible cross-border payments.

The Anti-Hybrid Rule

As applied to income, profit, or gains received by a U.S. resident that may be taxable by Canada, Article IV(7)(b) applies when the following conditions are met:

- a U.S. person is considered under Canadian tax law to have received an amount of income, profit, or gain from a Canadian resident entity;
- the Canadian payer entity is treated as a fiscally transparent entity under U.S. law; and
- by reason of the payer entity's fiscal transparency under U.S. law, the treatment of the amount under U.S. tax law is not the same as it would have been had the entity not been fiscally transparent under U.S. tax law (the same treatment test).

The first two conditions above involve relatively straightforward determinations, and will be satisfied, for example, anytime that the payer of the relevant income, profit, or gains is a Canadian unlimited liability corporation (ULC) that is not treated as a corporation under the U.S. check-the-box rules. (All ULCs in this article are assumed to be fiscally transparent for U.S. tax purposes and resident in Canada for treaty purposes.)

The meaning of the third condition is not self-evident. According to the U.S. Treasury technical explanation of the fifth protocol (the TE), an item of income, profit, or gain is considered to be treated the same if character, source, and timing are the same under the residence state's tax laws in each of the two compared scenarios. The guidance in the TE is based on a U.S. domestic regulation (Treas. reg. section 1.894-1(d)(3)(iii)), which deals with income earned through a fiscally transparent entity and not income paid by such an entity. While Canadian tax law contains no analogous test, the TE adds that it was anticipated that Canada would apply comparable principles, and the Canadian Department of Finance has publicly endorsed the TE.[3] The CRA provided its most comprehensive guidance on the interpretation of the same treatment test in a 2009 technical interpretation.[4] In the technical interpretation, the CRA stated that it will consider the U.S. tax treatment of an amount of Canadian-source income, profits, or gains to be ''the same'' as if the entity had not been fiscally transparent if each of the following three factors is the same for U.S tax purposes:

- the timing of the recognition of the amount;
- the character of the amount; and
- the quantum of the amount.

While the Canadian ''same treatment'' factors are not identical to those listed in the TE,[5] they may be said to be based on comparable principles.[6]

If all three conditions of Article IV(7)(b) are satisfied, the amount of income, profit, or gain in question is considered not to have been paid to or derived by a person who is a U.S. resident for purposes of the treaty. As a result, the amount does not qualify for any reduction of Canadian withholding tax or exemption from Canadian tax on business profits or capital gains, as the case may be, otherwise available under the treaty.

Application of Article IV(7)(b): Base Case

One common situation (illustrated in Figure 1) when Article IV(7)(b) may apply is when a Canadian ULC pays interest or royalties, which may be deductible in computing its Canadian taxable income, to a U.S. resident corporation that is its sole shareholder (USCo). In that case, the first two conditions in Article IV(7)(b) are satisfied in a straightforward manner. Regarding the third condition in Article IV(7)(b), under U.S. tax law, the payment is disregarded (and therefore

[3]*See* Canada, Department of Finance, ''Canada Supports U.S. Technical Explanation of the Fifth Protocol to the Canada-United States Income Tax Convention,'' Release No. 2008-052, July 10, 2008.

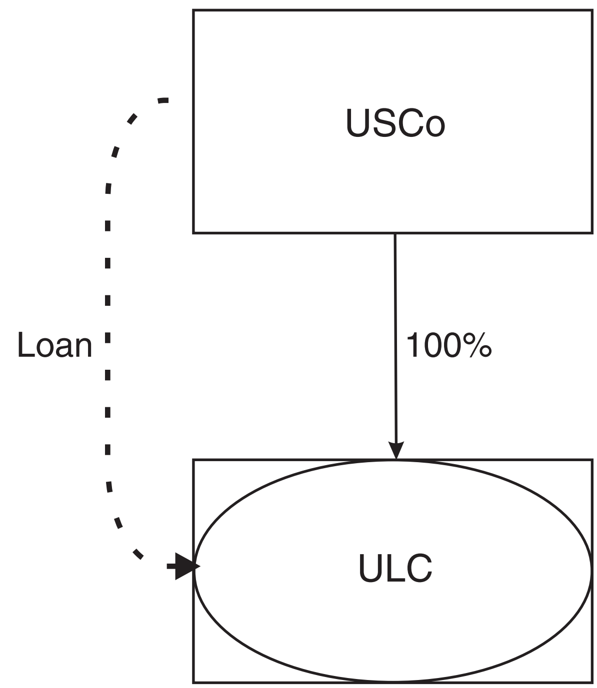
[4]CRA document no. 2009-0318491I7 (Nov. 13, 2009).

[5]Source is notably absent from the CRA's list of ''same treatment'' factors. The CRA took the position in the technical interpretation that a difference in the ''geographic source'' (for example, U.S. or non-U.S. source) of a payment is not relevant for purposes of the same treatment test, provided the geographic source does not modify the timing of recognition, the quantum, or the character of the amount for U.S. tax purposes. For instance, although the source (as determined for U.S. tax purposes) of a particular income item may affect the computation of the U.S. recipient's foreign tax credit limitation and thereby produce, in a broad sense, a U.S. tax ''difference,'' the CRA held that this type of difference was not sufficient to engage Article IV(7)(b), presumably because it had no impact on the timing, quantum, or character of the underlying income item itself.

[6]For more detailed discussions of the CRA's interpretation of the same treatment test and of the CRA's comments on its application to a broader range of structures than are discussed in this article, see Paul Seraganian and Matias Milet, ''Canada Clarifies Antihybrid Rule in U.S. Treaty,'' *Tax Notes Int'l*, Dec. 14, 2009, p. 831, *Doc 2009-26710*, or *2009 WTD 237-8*; and Matias Milet, ''When Is a 'Nothing' Something? Canada's Approach to Hybrid Entities Under the Canada-U.S. Treaty,'' *Tax Notes Int'l*, July 26, 2010, p. 273, *Doc 2010-14104*, or *2010 WTD 142-13*.

is not included in computing USCo's U.S. taxable income) because ULC is disregarded, whereas if ULC were treated as not fiscally transparent (that is, if it were regarded as a corporation), the payment would be treated as interest or royalties, as the case may be, that USCo would be required to include in its income. Thus, the same treatment test is not satisfied in this scenario (the base case). Both the TE and the published statements of the CRA[7] have maintained that Article IV(7)(b) applies in the base case to deny USCo the benefit of any treaty-based reduction of the Canadian withholding tax rate regarding the interest or royalty payment. Consequently, a 25 percent Canadian withholding tax would apply to the gross amount of such payment.[8] In the case of interest, the denial of treaty benefits is particularly detrimental; had the treaty applied, the ''rate'' of withholding tax on interest would have been 0 percent.[9]

Figure 1. Base Case



Workarounds Approved by the CRA

A significant tax advantage of the base case structure, before the coming into force of Article IV(7)(b), was that a payment of interest or royalties that generated a deduction in Canada was eligible for a treaty-reduced rate of Canadian withholding tax and was not includable in the payee's income for U.S. tax purposes. Although this is no longer achievable under the base case, there are some workaround transactions taxpayers have used to achieve comparable tax results without Article IV(7)(b) applying. In the technical interpretation, as well as in other published administrative statements, the CRA has approved the following two techniques for ensuring that Article IV(7)(b) does not apply to interest or royalty payments from a ULC to related U.S. resident entities, subject to the potential application of the GAAR to deny treaty benefits in particular situations:

- *Interest Payments by ULC to U.S. Grandparent (the grandparent alternative workaround).* The first technique, illustrated in Figure 2, involves all of the shares of a ULC being owned by a U.S. subsidiary (USSub) of a U.S. corporation (USCo). Rather than having USSub make a loan to the ULC (as in the base case scenario), USCo itself makes an interest-bearing loan to the ULC (or, if USSub already has a loan outstanding to the ULC, then that loan is replaced with a loan from USCo).[10] USCo and USSub file a consolidated tax return for U.S. federal income tax purposes. Since, for such purposes, USCo is considered to have made a loan to USSub (because the ULC is disregarded as an entity separate from its shareholder, USCo), the interest on that loan is included in the income of USCo although USSub is entitled to an interest expense deduction (subject to the discussion below of the DCL rules). If the ULC were not fiscally transparent for U.S. tax purposes, on the other hand, there would be no offsetting interest expense deduction available to

[7] *See, e.g.,* CRA document no. 2009-0318491I7 (Nov. 13, 2009).

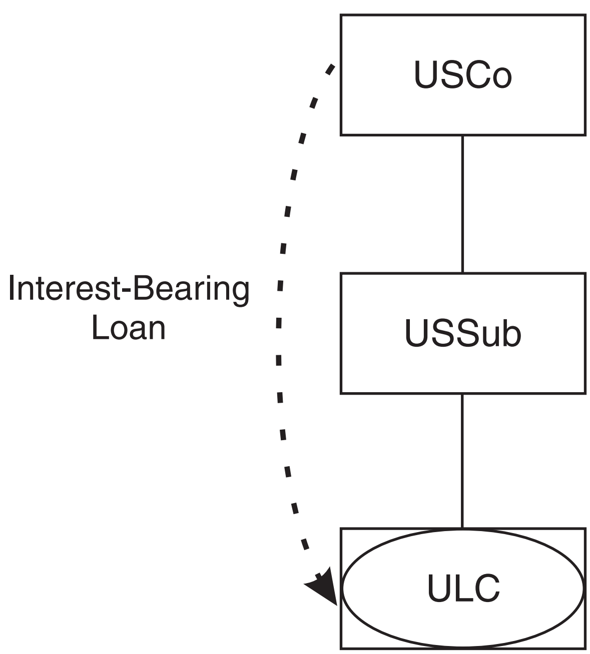
[8] Section 212 of the Income Tax Act. If Article IV(7)(b) did not apply, and provided the other requirements under the treaty were satisfied, the reduced Canadian withholding tax rates available under the treaty would be 0 percent for interest (under Article XI of the treaty) and either 0 percent or 10 percent for royalties (under Article XII of the treaty).

[9] *See* Article XI(1) (allowing only the residence state to tax interest arising in the other state). The most common circumstance in which a U.S. resident will need to rely on Article XI(1) of the treaty for an exemption from Canadian withholding tax on interest will be in the case of related-party interest, since Article XI(1) does not distinguish between interest paid to a related party and interest paid to an unrelated party. In contrast, under Canadian domestic law, a broad exemption from Canadian withholding tax on (nonparticipating) interest only applies if the payer and payee deal with one another at arm's length.

[10] The loan from USSub to ULC can be replaced, for example, either by USSub transferring the loan receivable to USCo, or by USCo making a loan to the ULC, the proceeds of which the ULC uses to repay the loan from USSub. Also, although referred to here as the ''grandparent alternative workaround,'' it is not essential that the interest recipient be a parent of the ULC's sole shareholder. The same results could be achieved if the lender were any other member of the same U.S. consolidated return group as the ULC's shareholder (for example, a sister company or even a subsidiary of the ULC shareholder).

the USCo consolidated group because the interest would be considered to be paid by a foreign corporation (the ULC) and not by USSub. The CRA has nevertheless indicated that the same treatment test would be satisfied in this circumstance because only the income item to which Canadian withholding tax potentially applies (that is, the interest payment), and not the corresponding expense item (that is, the interest deduction), is relevant for purposes of the same treatment test in Article IV(7)(b).[11] Since USCo would be considered to have received interest income, and would recognize such income on an accrual basis, whether or not the ULC is fiscally transparent for U.S. tax purposes, the same treatment test is satisfied and Article IV(7)(b) does not apply.[12]

Figure 2. Grandparent Alternative



- *ULC With More Than One Shareholder (the partnership alternative workaround)*. This second technique, illustrated in Figure 3, involves USCo and its subsidiary corporation, USSub, each owning shares of a ULC that is fiscally transparent for U.S. purposes. The ULC has a debt owing to USCo. The ULC is treated as a partnership for U.S. tax purposes, rather than as a disregarded entity because it has more than one shareholder. For U.S. tax purposes, interest paid by the ULC is included in USCo's income on an accrual basis, which is the same treatment that would apply if the ULC were regarded as a corporation. Because the ULC is treated as a partnership for U.S. tax purposes, the increase in USCo's income regarding the interest paid by ULC would be offset by the partnership allocation to USCo of USCo's share of the ULC's interest expense (subject to the DCL rules).[13] If instead the ULC were not fiscally transparent, there would be no such offset. As in the first workaround above, the CRA indicated that the same treatment test would be satisfied in this case, despite USCo's interest deduction, because only the interest income, and not the corresponding interest expense deduction, is relevant for purposes of the same treatment test in Article IV(7)(b). Thus, the CRA's position was that Article IV(7)(b) would not apply to interest payments made by the ULC to USCo.

The CRA has indicated on several occasions, including in the technical interpretation in 2009, that although each of the above workaround techniques meets the technical requirements to avoid Article IV(7)(b), the CRA may nevertheless consider applying the GAAR to deny treaty benefits in some circumstances.

The Canadian GAAR

In general, the Canadian tax consequences of a transaction are determined based on the legal form rather than the economic substance of the transaction. The principle that a taxpayer is entitled to arrange his affairs in order to minimize tax payable continues to be respected by Canadian courts, but this principle has been attenuated by the enactment (in 1988) of the GAAR, found in section 245 of the Income Tax Act (Canada).[14] When the GAAR applies to a transaction, the CRA may redetermine the tax consequences to a person as is reasonable in the circumstances in order to deny a tax benefit that would otherwise obtain. The GAAR applies if the following conditions are all met:

- a ''tax benefit'' has resulted directly or indirectly from a transaction or series of transactions;

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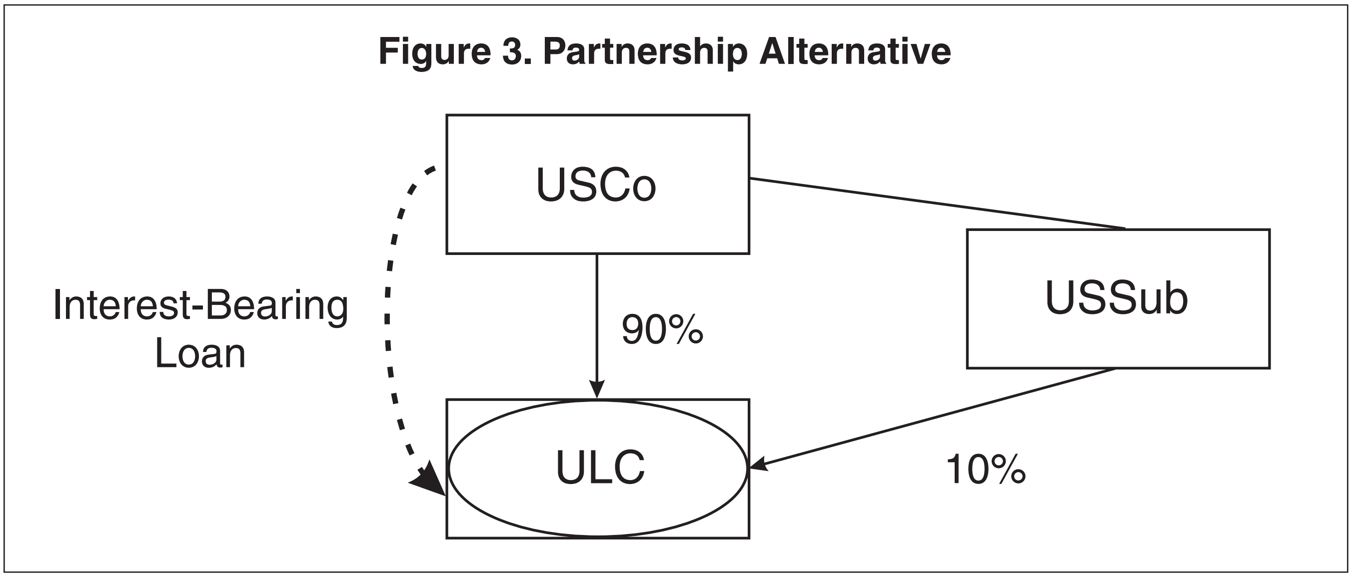
[11] CRA document no. 2009-031849117 (Nov. 13, 2009).

[12] Although the interest income received by USCo may be U.S. source under actual circumstances, when the payer is USSub, and non-U.S. source in the hypothetical scenario when ULC is not fiscally transparent, the CRA generally does not consider geographic source to be a relevant factor in applying the same treatment test. *See supra* note 4.

[13] Presumably, USCo would hold most of the shares of ULC, such that it would be allocated most of the ULC's interest expense for U.S. tax purposes. However, the CRA has not discussed how small USSub's percentage ownership in ULC may be in this structure.

[14] *See* the discussion of ''Legal Form vs. Economic Substance'' in Steve Suarez and Susan Wooles, ''Ten Essential Elements of Canada's Tax System,'' *Tax Notes Int'l,* Sept. 8, 2008, p. 825, *Doc 2008-17137*, or *2008 WTD 177-11*.



- the transaction in question is an ''avoidance transaction,'' or the series of transactions in question includes an avoidance transaction; and
- it may reasonably be considered that the transaction in question results directly or indirectly in a misuse of the provisions of the ITA *or a tax treaty*, or would result directly or indirectly in an abuse (taking into account those provisions read as a whole).[15]

For purposes of the GAAR, a ''tax benefit'' includes a reduction, avoidance, or deferral of tax or other amount payable under the ITA. It does not include a reduction of tax payable under the laws of a foreign country.[16] An ''avoidance transaction'' is one that, either alone or as part of a series of transactions, gives rise to a tax benefit, unless the transaction may reasonably be considered to have been undertaken primarily for bona fide purposes other than to obtain the tax benefit in question.[17]

Although the ITA does not provide any further statutory guidance regarding the ''misuse or abuse'' analysis (the third condition for the application of GAAR), the Supreme Court of Canada has endorsed a two-step GAAR inquiry under subsection 245(4) to determine whether an avoidance transaction conferring a tax benefit results in abusive tax avoidance.[18]

The first step in the analysis is to determine the object, spirit, or purpose of the provisions of the ITA (or treaty) that are either relied on for the tax benefit or circumvented in order to obtain the tax benefit in question, in each case taking into account the scheme of the ITA (or treaty), the relevant provisions, and permissible extrinsic aids.

The second step is to examine the factual context of the transaction(s) to determine whether the avoidance transaction defeated or frustrated the object, spirit, or purpose of the provisions in issue.

The Supreme Court has stated that a misuse or abuse can result either when:

- a provision or provisions are relied on or applied by the taxpayers in order to achieve an outcome that the provisions seek to prevent;
- a transaction defeats the underlying rationale of the provisions that are relied on; or
- the transaction(s) circumvent the application of certain provisions, such as specific antiavoidance rules, in a manner that frustrates or defeats the object, spirit, or purpose of those provisions.[19]

Although the GAAR is part of Canadian domestic law, it may apply to deny a tax benefit conferred by a tax treaty when there has been a misuse or abuse of one or more provisions of a treaty.[20] It is therefore

[15]Subsection 245(4) of the ITA.

[16]Subsection 245(1) of the ITA.

[17]Subsection 245(3) of the ITA.

[18]*See The Queen v. Canada Trustco Mortgage Company*, 2005 DTC 5523 (SCC); *Kaulius v. The Queen*, 2005 DTC 5538 (SCC) (sub nom. *Mathew v. The Queen*); and *Lipson v. The Queen*, 2009 DTC 5015.

[19]*Canada Trustco,* para. 45.

[20]Moreover, Article XXIX A(7) of the treaty preserves the right of each of the contracting states to apply domestic antiabuse rules to counter treaty abuse, although in the context of Article XXIX A (limitation on benefits), it is unclear to what extent Article XXIX A(7) contemplates the application of domestic antiabuse rules in contexts other than those involving perceived treaty shopping.

theoretically possible that GAAR could apply to transactions that circumvent the application of a treaty antiavoidance provision (like Article IV(7)(b)) in an abusive manner.

Potential Application to Workarounds

When a transaction or series of transactions is undertaken in order to effect one of the two Article IV(7)(b) workaround transactions discussed above, the first two conditions for the application of the GAAR might be considered to be met, depending on the particular transactions. By avoiding the application of Article IV(7)(b), such transactions might be considered to result in a tax benefit, namely the reduction of Canadian withholding tax on interest or royalty payments (since if Article IV(7)(b) had applied, the applicable withholding tax rate would have been the 25 percent rate under the ITA, rather than the reduced rate under the treaty). Also, it is possible that one of the transactions in the series of transactions implementing the workaround would be considered an avoidance transaction.

The applicability of the GAAR to an Article IV(7)(b) workaround transaction, then, may most often turn on whether the transaction in question results in a misuse or abuse of any provision(s) of the ITA or the treaty.[21] Applying the Supreme Court's two-step GAAR misuse or abuse inquiry, outlined above, the first step in the analysis is to determine the object, spirit, and purpose of any provisions of the ITA or of any treaty that are either relied on by the taxpayer to obtain the tax benefit in question, or whose application is circumvented to achieve the tax benefit. Since transactions implementing either of the workaround techniques described above are designed to circumvent the application of Article IV(7)(b), it is necessary to determine the object of that provision. Article IV(7)(b) potentially applies when a hybrid entity resident in one contracting state makes a cross-border payment to a taxpayer resident in the other contracting state and the latter state treats the entity as fiscally transparent. The purpose of the article seems to be that in those circumstances treaty benefits should be denied if the recipient is not treated as having recognized the payment as income. There is not much more that can be gleaned from the wording of the rule alone about the treaty negotiators' purpose in adding this rule to the treaty. The purpose of Article IV(7)(b) is not specifically addressed by the TE. However, the separate explanation of the fifth protocol issued on July 8, 2008, by the U.S. Congressional Joint Committee on Taxation (the JCT report) states that the purpose of Article IV(7)(b) is to curtail the use of hybrid fiscally transparent entity structures to facilitate:

- duplicated interest deductions in the U.S. and Canada; or
- a single, internally generated interest deduction in one country without offsetting interest income in the other country.[22]

Although the rule has not actually been fashioned to target duplicated interest deductions,[23] the CRA seems to agree with this interpretation of the purpose of Article IV(7)(b).[24] It is not clear, however, whether a Canadian court would accept that the purpose of Article IV(7)(b) can be identified with any greater precision than what appears from the words in the treaty.[25]

After attempting to identify the object, spirit, and purpose of Article IV(7)(b), the second step in the misuse or abuse analysis, according to the Supreme Court, is to determine whether the particular Article IV(7)(b)

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[21] As noted, subsection 245(4) of the ITA expressly provides that the GAAR applies not only in the case of an abuse or misuse of the provisions of the ITA, but also when there is an abuse or misuse of the provisions of one of Canada's tax treaties.

[22] JCT report, p. 101.

[23] In particular, the preamble to Article IV(7) refers to ''an amount of income, profit or gain,'' and the same treatment test in Article IV(7)(b) then requires a consideration of whether the ''treatment of the amount'' (apparently referring to the amount of income, profit, or gain referenced in the preamble) is the same under the tax law of the residence state as it would be if the hybrid payer entity were not fiscally transparent. Thus, the wording of Article IV(7)(b) suggests that the underlying policy of that provision relates exclusively to the treatment of the income item by the residence state and not that of the expense item or the effect of consolidation (which may result in offsetting income and expense items in computing the U.S. group's consolidated taxable income). For this reason, it is unclear how a purpose of Article IV(7)(b) may be said to be the prevention of duplicated interest deductions in the U.S. and Canada. In contrast, it is clearly a purpose of that provision to prevent the use of hybrid entities to obtain an internally generated interest deduction in one country (for example, Canada) without offsetting interest income in the other country (for example, the U.S.).

[24] *See* ''Canada Revenue Agency Round Table,'' *Report of Proceedings of Sixty-First Tax Conference*, 2009 Tax Conference (Toronto: Canadian Tax Foundation, 2010), 3:1-29, at 3:8:

> The GAAR may apply if the ULC is part of a financing arrangement that results in, among other things, duplicated interest deductions or an internally generated interest deduction in one country without offsetting interest income in the other country.

[25] In *Canada Trustco*, the Supreme Court of Canada stated that in order for the Minister of National Revenue (MNR) to discharge its burden of proving a misuse or abuse under GAAR, ''the abusive nature of the transaction must be clear,'' which means that the MNR must be able to convincingly identify the purpose of the provisions being relied on by the taxpayer (or circumvented, as the case may be). Recently, in *Lehigh Cement Ltd. v. R.*, 2010 D.T.C. 5081, the Federal Court of Appeal applied this standard and found that a single reference in a Canadian federal budget paper to the purpose of an exemption from withholding tax in the ITA was ''a shaky foundation for an assessment under the general anti-avoidance rule in section 245 of the *Income Tax Act*.''

workaround transaction at issue circumvents that provision in a manner that frustrates or defeats that object, spirit, or purpose. Whether a particular transaction or series of transactions implementing one of the two Article IV(7)(b) workaround techniques discussed above results in abusive tax avoidance will depend on the particular transactions and circumstances.

Initial CRA Statements

The CRA has issued several rulings indicating that it will not apply the GAAR to deny treaty benefits regarding deductible payments by a Canadian ULC in particular situations involving grandparent alternative workaround transactions. CRA document number 2009-0348041R3 (Apr. 21, 2010),[26] for example, involved the transfer of an interest-bearing debt from a U.S. subsidiary (which was the sole shareholder of a Canadian resident ULC) to its U.S. parent corporation. The purpose of the transactions, as represented by the taxpayer to the CRA in its ruling request, was to avoid the application of Article IV(7)(b) to the interest payments from the ULC to the U.S. parent. The CRA nevertheless ruled that the GAAR would not apply to the transactions ''in and by themselves,'' wording that may have been selected to leave open the possibility that additional context could in some cases lead to a different conclusion under GAAR. The CRA did not comment, however, on what considerations, if any, might cause it to apply the GAAR to such a workaround transaction. It therefore seemed that the GAAR would generally not be used by CRA to attack ordinary transactions of the grandparent alternative workaround type.

Recent CRA Administrative Developments

CRA Comments at 2010 ABA Panel Discussion

At a fall 2010 ABA panel discussion,[27] a member of the CRA's Income Tax Rulings Directorate commented on the potential applicability of the GAAR to an Article IV(7)(b) grandparent alternative workaround transaction and in the process provided an indication of some considerations the CRA might take into account in determining whether to apply the GAAR to such transactions. The ABA panelists considered two similar examples involving grandparent alternative workaround transactions. In both examples, as in the previous examples discussed above, a Canadian ULC was wholly owned by a U.S. subsidiary (USCo) of a U.S. corporation (U.S. Parent), and USCo and U.S. Parent filed a consolidated U.S. tax return. As in the grandparent alternative workarounds previously considered by the CRA, the proposed transactions involved the transfer of an interest-bearing note (the old note), which the ULC had issued to USCo, from USCo to another affiliate within the U.S. Parent group (the new creditor), with a new note then being substituted for the old note. The purpose of the transactions was to avoid the application of Article IV(7)(b) to interest payments on the old note. Regular interest payments would subsequently be made by ULC to the new creditor under the terms of the new note.

The examples at the ABA panel discussion differed from the grandparent alternative workaround transactions previously considered by the CRA (and discussed above) principally in that in the ABA examples, the relevant Canadian ULC was the sole limited partner in a Canadian limited partnership (Canada LP) that carried on a business in Canada. Canada LP was a reverse hybrid, that is, it was a partnership for Canadian tax purposes but had checked the box to be considered a corporation for U.S. tax purposes. The key distinction between the two ABA examples was that in the first example (ABA example 1), Canada LP distributed all of its Canadian earnings and profits currently to ULC, and such distributions were recognized as income of USCo for U.S. tax purposes because ULC was fiscally transparent for U.S. tax purposes. In the second example (ABA example 2), illustrated in Figure 4, on the other hand, Canada LP did not distribute all its Canadian earnings and profits currently. Another difference was that the holder of the limited partnership interest in Canada LP (that is, ULC) was a pure holding company in ABA example 1 whereas in ABA example 2 ULC also directly carried on business in Canada.

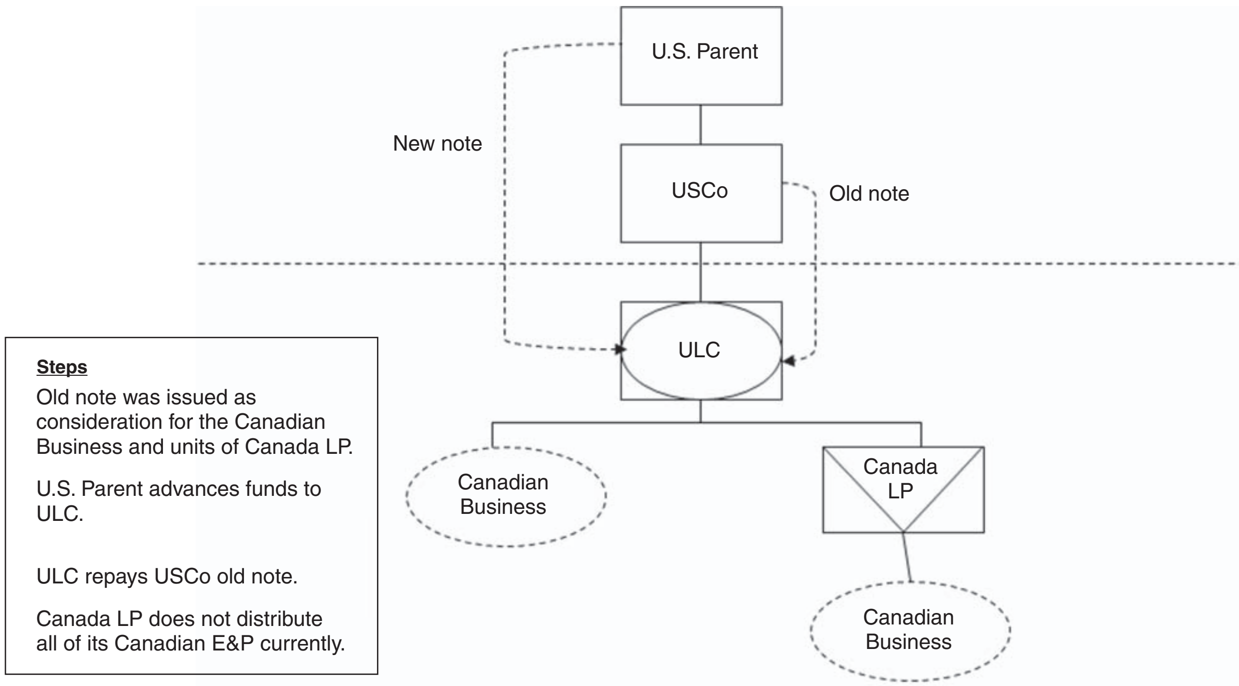
Regarding ABA example 1, the CRA member of the panel agreed that, consistent with the prior CRA rulings regarding grandparent alternative workaround transactions discussed above, Article IV(7)(b) would not apply to deny treaty benefits (being the elimination of Canadian withholding tax on interest under Article XI of the treaty) for interest payments on the new note from ULC to the new creditor. Payments would be treated as interest income to the new creditor regardless of whether ULC was fiscally transparent for U.S. tax purposes. The CRA official further stated that the CRA would not apply the GAAR in ABA example 1, a conclusion that seemed to be based in some measure on the fact that Canada LP distributed all its earnings currently with the result that such income was being recognized in the U.S. currently. It was not specified whether such income exceeded the ULC's interest expense.

Regarding ABA example 2, the CRA official stated that the GAAR might apply in that case because, as a result of Canada LP not distributing all its Canadian earnings and profits currently, such earnings would not

[26]*See also* CRA document no. 2010-0372181R3 (Aug. 8, 2010).

[27]Patrick Brown, Ginny Chung, Phil Jolie, Jeffery G. Mitchell, Elinore J. Richardson, and Marjorie A. Rollinson, ''Doing Business in Canada: What U.S. Multinationals Need to Know,'' 2010 Joint Fall CLE Meeting of the ABA Section of Taxation and Real Property, Trust & Estate Law (Toronto, Sept. 23-25, 2010).

Figure 4. ABA Example 2



be recognized as income of USCo for U.S. tax purposes on a current basis. However, although this may not have reflected an official CRA position, the CRA official appears to have been open to the possibility that the CRA may consider the application of the U.S. DCL rules (described below) in that case as support for not applying the GAAR.[28]

To better appreciate the ABA panel discussion comments regarding the potential relevance of the DCL rules for the GAAR analysis, as well as subsequent related CRA administrative developments, a very brief summary of the relevant aspects of the DCL rules and their applicability to ABA example 2 is set out as follows:

- *When the DCL Rules Apply*: In the context of a Canadian ULC owned by a U.S. domestic corporation that is a member of a U.S. consolidated return group, the DCL rules would generally apply when the ULC (which for these purposes would be considered a separate unit, specifically a ''hybrid entity separate unit'')[29] has a net operating loss for a tax year.

  In ABA example 2, since the new note is issued by ULC (which is a branch of USCo for U.S. tax purposes) and is regarded for U.S. tax purposes, it will create a U.S. interest deduction. To the extent that such deduction exceeds the income from the Canadian business conducted by ULC, the ULC would have a net operating loss. For purposes of the DCL rules, ULC is a separate unit and the net loss attributable to the separate unit is a DCL.

- *Computing a DCL*: In the case of a regarded debt, such as the new note, the DCL rules require a determination of whether a separate unit or dual resident corporation[30] has a DCL regarding such debt, calculated in accordance with U.S. tax principles. In general terms, a dual resident corporation (including a separate unit, like ULC) has a DCL to the extent it has a net operating loss.[31] Net income or loss of the separate unit is computed for each tax year of the consolidated group, and the amount of the interest expense on any

[28]The DCL rules are in section 1503(d) of the U.S. Internal Revenue Code and the regulations prescribed thereunder.

[29]*See* Treas. reg. section 1.1503(d)-1(b)(3) and (4) (treating a separate unit as a separate domestic corporation for purposes of DCL rules) and Treas. reg. section 1.1503-2(c)(2) (treating separate unit as dual resident corporation).

[30]*See* Treas. reg. section 1.1503(d)-1(b)(2).

[31]*See* Treas. reg. section 1.1503(d)-1(b)(5).

(Footnote continued in next column.)

"regarded" debt owed by the separate unit for the year is deducted in the computation of that income or loss.[32]

Thus, in ABA example 2, the DCL rules require a DCL computation for ULC as a separate unit of USCo, and ULC's interest expense on the new note is deducted in computing its net income or loss for these purposes. A net operating loss of ULC would be a DCL. In ABA example 2, there would be a DCL of ULC if the net income from ULC's Canadian business is not at least equal to ULC's interest expense on the new note.[33]

- *Effect of DCLs*: DCLs are not deductible in computing the "consolidated taxable income" of the U.S. consolidated group of which the particular U.S. taxpayer that incurs the DCL is a member, since a "domestic use" of a DCL of the separate unit is generally not permitted.[34] When the net loss of the separate unit has a "foreign use," for example deductibility under local tax law, a "domestic use" election is not available regarding the DCL of the separate unit.[35] In this case, the effect of the separate unit having a DCL is that the loss generally cannot offset the taxable income of any "domestic affiliate."[36] The DCL of the separate unit may, however, be carried forward or back and deducted in computing the consolidated taxable income of the U.S. consolidated group in another tax year, to the extent that the separate unit has net taxable income in that tax year as determined under the DCL rules.[37]

Thus, in the event that the amount of ULC's net income from the Canadian business is less than ULC's interest expense, resulting in a DCL, then assuming such interest expense was deductible for Canadian tax purposes, the resulting DCL would have a "foreign use" so that a "domestic use" election would not be available. In that case, the U.S. interest deduction otherwise available to the U.S. consolidated group would be denied to the extent of the DCL incurred by USCo in the year, although the related interest expense could be deductible by the U.S. consolidated group in a subsequent tax year to the extent ULC had net income in that later/earlier year.

The ABA panel discussion did not make explicit the rationale for the DCL rules possibly being relevant to the determination of whether to apply the GAAR to an Article IV(7)(b) workaround transaction. However, one theme that emerged from the ABA panel discussion is that the CRA was considering factoring into its GAAR analysis of Article IV(7)(b) workarounds whether the U.S. tax base was being eroded (for example, through the use of a non-U.S. reverse hybrid that does not distribute earnings and profits currently, combined with the use of a ULC that generates a U.S. interest deduction). The CRA official present acknowledged it would be surprising if the application of Canadian withholding tax and the GAAR were to depend on whether U.S. tax was being avoided (particularly if that question turned on whether U.S. DCL rules apply), but he seemed to indicate that the CRA might nonetheless consider taking U.S. tax minimization into account in its GAAR analysis.

Impact of DCL Rules on GAAR Determination

After the ABA panel discussion, in a ruling issued on January 19, 2011 (the 2011 ruling),[38] the CRA ruled on the applicability of the GAAR to a grandparent alternative workaround transaction and again seemed to take account of the DCL rules for purposes of the GAAR analysis. A simplified version of the situation considered by the CRA in the 2011 ruling is illustrated in Figure 5 and the relevant aspects were as follows. A ULC (CancoSub), which was wholly owned

[32]In computing the income or DCL of a separate unit, only those existing (regarded) items of income, gain, deduction, and loss of the separate unit's domestic owner are taken into account. Treas. reg. section 1.1503(d)-5(c)(1)(ii).

[33]The relatively schematic listing of U.S. tax consequences considered at the ABA panel discussion did not take into account that Canada LP, being a controlled foreign corporation, may have subpart F income that may have to be included in income by ULC in order to compute its net income or loss under the DCL rules. (See U.S. Treas. reg. section 1.1503(d)-5(c)(4)(iv).) Our discussion likewise assumes that Canada LP generates no subpart F income.

[34]Treas. reg. section 1.1503(d)-4(e).

[35]Subject to some exceptions, a foreign use of a DCL is deemed to occur when any portion of a deduction or loss taken into account in computing the DCL is made available under the income tax laws of a foreign country to offset or reduce, directly or indirectly, any item that is recognized as income or gain under such laws and that is, or would be, considered under U.S. tax principles to be an item of:

- a foreign corporation (as defined in section 7701(a)(3) and (a)(5) of the IRC); or
- a direct or indirect owner of an interest in a hybrid entity, provided such interest is not a separate unit.

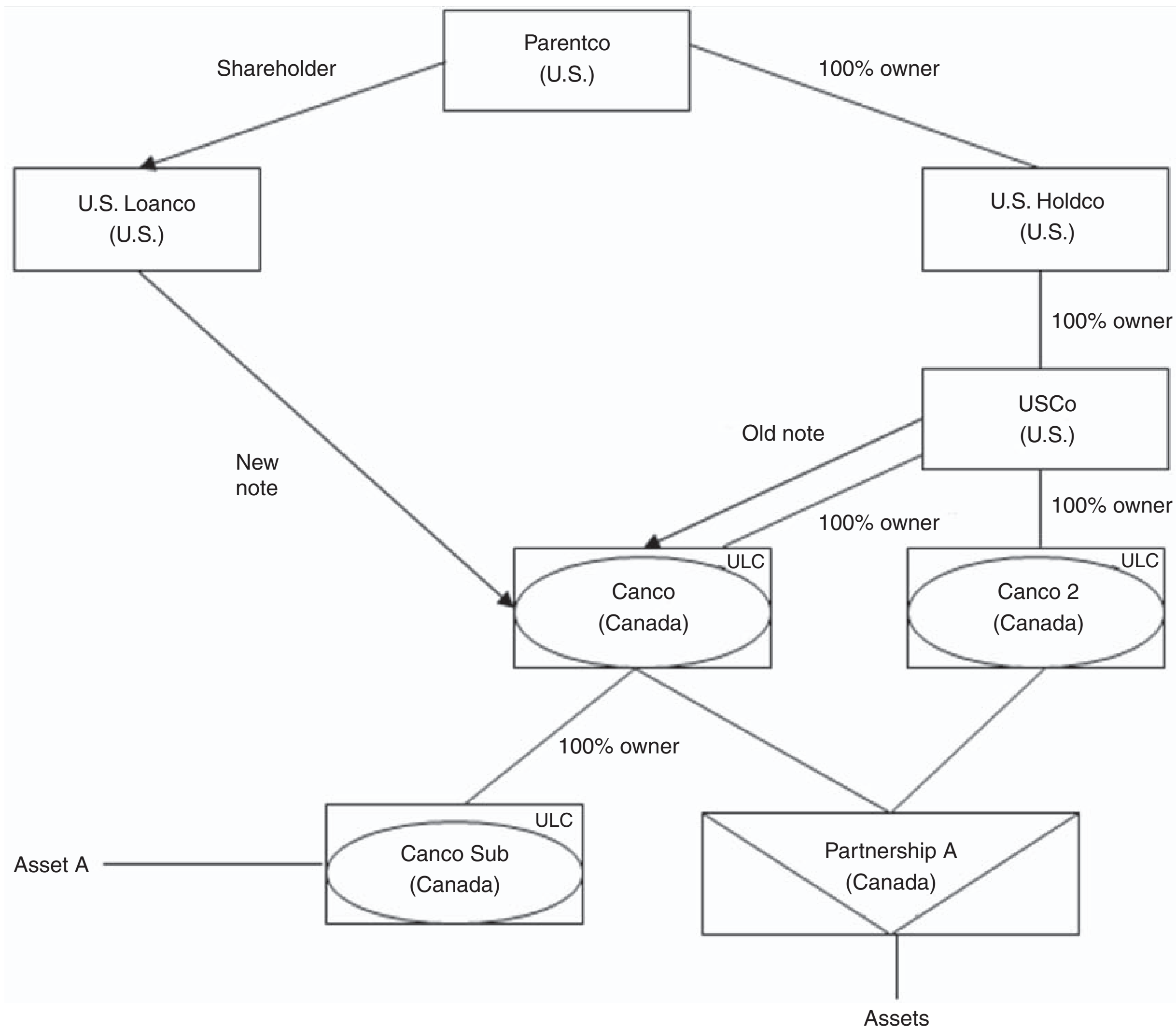
See Treas. reg. section 1.1503(d)-3(a).

[36]Treas. reg. section 1.1503(d)-4(b) and (c).

[37]Treas. reg. section 1.1503(d)-4(c). There is a debate in the U.S. tax community as to whether a current year DCL may be deducted currently against U.S. consolidated taxable income. *See* comments made by David Bailey, branch 4 senior technical reviewer, IRS Office of Associate Chief Counsel (International), on September 24, 2010, at an ABA meeting concerning the application of SRLY rules to DCLs. *See* Amy S. Elliott, "SRLY Rules Allow Favorable Usage of Dual Consolidated Losses, IRS Official Says," *Doc 2010-20928* or *2010 WTD 186-2*.

[38]CRA document no. 2010-0361591R3 (Jan. 1, 2010).

Figure 5. 2011 Ruling



by another ULC (Canco), held some income-earning assets. Canco and a third ULC (Canco2) were the sole partners of a reverse hybrid Canadian general partnership (Partnership A), which held some income-earning assets. Each of CancoSub, Canco, and Canco2 were disregarded and thus were fiscally transparent for U.S. tax purposes. Canco and Canco2 were both wholly owned by a wholly owned U.S. subsidiary (USCo) of a U.S. corporation (U.S. Holdco). U.S. Holdco was in turn wholly owned by a U.S. corporation (Parentco), which also wholly owned, directly and indirectly, another U.S. corporation (U.S. Loanco). USCo, U.S. Holdco, Parentco, and U.S. Loanco were members of the same U.S. consolidated return group. Before the proposed transaction, USCo held an interest-bearing note (the old note) outstanding from Canco. As part of the proposed transactions, U.S. Loanco made an interest-bearing loan to Canco, evidenced by a new note issued by Canco, the proceeds of which were used by Canco to repay the old note. The proposed transaction consisted of Canco paying interest to U.S. Loanco under the terms of the new note.

The 2011 ruling contained, under the heading ''Additional Information,'' an explanation of the U.S. tax treatment of the interest payable by Canco to U.S. Loanco. The ruling stated that:

- The respective ''separate taxable incomes'' of Parentco, U.S. Holdco, USCo, and U.S. Loanco, calculated under the U.S. code, would all be included in calculating the Parentco group's ''consolidated taxable income.''
- U.S. Loanco would be required to include in computing its ''separate taxable income'' the amount

of interest accruing on the new note in the year, and the payment of interest by Canco to U.S. Loanco on the new note would not be disregarded for U.S. tax purposes and would be treated as a payment of interest to U.S. Loanco.

- Interest expense on the new note may be deductible in computing the consolidated taxable income of the Parentco group (since the interest would be considered to be payable by USCo to U.S. Loanco because of Canco's fiscal transparency for U.S. purposes), *subject to the application of the DCL rules*.
- Regarding the application of the DCL rules, for purposes of determining whether USCo has a DCL, Canco, Canco2, and CancoSub would be a (combined) ''separate unit'' of USCo,[39] the net income or loss of which would be computed for each tax year of the Parentco group. The amount of Canco's interest expense on the new note would be deducted in computing the net income or loss of the separate unit, and may result in a DCL to USCo. Interest expense on the new note, to the extent of a resulting DCL, if any, would not be deductible in computing the consolidated taxable income of the Parentco group.[40] However, interest expense on the new note that is attributable to a DCL of the separate unit may be deductible in computing the consolidated taxable income of the Parentco group in another tax year, but only to the extent that the separate unit has taxable income in that year under the DCL rules.

The CRA stated in the 2011 ruling that:

- Article IV(7)(b) would not apply to the payment of interest by Canco to U.S. Loanco on the new note; and
- the GAAR would not apply to redetermine the tax consequences in that case.

While the possibility of the DCL rules denying the use of some or all of the Canadian combined separate unit interest expense in computing the Parentco group's consolidated taxable income is mentioned in the 2011 ruling, the CRA does not discuss what weight was given to this consideration in issuing a favorable GAAR ruling. It is notable, however, that the taxpayer's representations (reproduced in the ruling) did not address whether the underlying Canadian reverse hybrid (Partnership A) distributed income currently to the Canadian ULC. Further, as noted, the taxpayer's ruling application stated that a DCL would arise *if* there was a net loss in the U.S. taxpayer's Canadian branch as a separate unit, implicitly leaving open the possibility that the underlying reverse hybrid would not make current distributions to the ULC/branch, or that such distributions may be insufficient in some years to offset the ULC's interest expense (resulting in a net loss).[41] Thus, notwithstanding some comments made at the ABA panel discussion, the 2011 ruling suggests that the CRA may *not* apply the GAAR to a grandparent alternative workaround transaction regardless of whether, in any particular tax year, the underlying reverse hybrid distributes its income currently or the DCL rules apply to deny an interest deduction to the U.S. consolidated group. However, the CRA may well have taken comfort from the fact that the DCL rules were potentially applicable to deny a U.S. interest deduction to the extent of insufficient U.S. income recognition.

Should the DCL Rules Be Relevant?

One may be taken aback by the possibility that the reduction of U.S. tax could play a significant role in determining whether a Canadian antiavoidance rule should apply.[42] Admittedly, Article IV(7)(b) is a rule that, when applied by the source country, is designed to take into account residence state tax treatment, since it requires a determination of whether the treatment of an amount is the same under the tax law of the state of residence whether or not the payer is fiscally transparent under such law. Accordingly, an analysis of whether the Canadian GAAR applies to a particular transaction that circumvents the application of Article IV(7)(b) regarding a deductible payment to a U.S. resident ought in some way to be attuned to the treatment of that amount under U.S. tax law.

[39] *See* Treas. reg. 1.1503(d)-1(b)(4)(ii):

> if a domestic owner, or two or more domestic owners that are members of the same consolidated group, have two or more separate units (individual separate units), then all such individual separate units that are located (in the case of a foreign branch separate unit) or subject to an income tax either on their worldwide income or on a residence basis (in the case of a hybrid entity an interest in which is a hybrid entity separate unit) in the same foreign country shall be treated as one separate unit (combined separate unit).

[40] This is because a U.S. domestic use of the DCL of the separate unit will not be permitted. Also, the losses of the separate unit will have a foreign use, within the meaning of the DCL rules, because the expenses attributable to the loss, including the interest expense on the new note, will be deductible under the ITA. As a consequence, a domestic use election could not be made regarding any DCL of the separate unit. Treas. reg. section 1.1503(d)-3(a) and Example 6 in Treas. reg. section 1.1503(d)-7(c). There is a foreign use because the loss is available to offset the income attributable to Partnership A.

[41] Treas. reg. section 1.1503-2(d)(2).

[42] *See* Angelo Nikolakakis, ''The Unthinkable Anathema of Double Non-Taxation: The Relevance and Implications of Foreign Tax Considerations in the Context of Applying GAAR,'' *Canadian Tax J.*, Vol. 58 (Special Supplement) (2010), pp. 243-301.

However, Article IV(7)(b) authorizes only a limited consideration of residence state tax treatment. In particular, that provision applies to an ''amount of income, profit or gain'' where *that amount* is treated differently for tax purposes in the residence state because of the fiscal transparency of the payer. Accordingly, in applying Article IV(7)(b) to an amount paid by a Canadian hybrid entity to a U.S. resident, U.S. tax rules should be relevant only to the extent that they bear on the treatment of the relevant income item (for example, interest, royalties). The CRA acknowledged as much in its interpretation of the same treatment test in the technical interpretation, in which it stated:

> The determination of whether the quantum of the amount is not the same under Article IV(7)(b) is made without reference to losses, deductions or credits available under the [U.S. Internal Revenue] Code in computing the United States tax liability of the recipient of the amount, or in the computation of the consolidated taxable income of a group of corporations which includes the recipient. In other words, the determination of same treatment will be made by reference to the gross amount of the item of income.[43]

As noted, this was the reason for the CRA's position that Article IV(7)(b) would not apply in the case of the two Article IV(7)(b) workaround transactions discussed above, in which the U.S. interest income inclusion and interest expense deduction offset each other (in the case of the grandparent alternative workaround, in computing the consolidated taxable income of the corporate group).

Similarly, the application of the GAAR to Article IV(7)(b) workaround transactions should be circumscribed to the clear purpose of Article IV(7)(b). As discussed above, regarding amounts paid by domestic reverse hybrids, the purpose of the rule appears to be to require income recognition in the residence country (as a precondition of granting treaty benefits). Thus, in determining whether a workaround transaction results in abusive avoidance of Article IV(7)(b), such that the GAAR applies, only the U.S. tax treatment of the relevant amount paid should be relevant. In particular, Article IV(7)(b) contains no reference to the related expense item, or any indication that the application of U.S. group consolidation rules is relevant (since those rules do not affect the treatment of the income item, specifically). Therefore, whether U.S. tax is avoided as a result of an underlying Canadian reverse hybrid failing to distribute its income currently should not be relevant to whether a workaround transaction results in abusive tax avoidance of Article IV(7)(b). Similarly, the DCL rules, which have no bearing on the U.S. treatment of the income item but only on the deductibility for U.S. purposes of the related expense item, should not be relevant to whether a transaction results in abusive avoidance of Article IV(7)(b) such that the GAAR is triggered.

More generally, it would seem inconsistent with the manner in which countries generally agree to allocate taxing jurisdiction in a tax treaty for one of them to follow a particular item of income into the recesses of the foreign tax system to make treaty benefits depend on how that item of income interacts with a potentially limitless category of foreign tax rules. In an analogous context, for purposes of determining treaty residence, Canadian courts and tax authorities generally do not concern themselves with the extent to which an entity organized or based in a treaty country is actually subject to tax therein so long as that country exercises full taxing jurisdiction over the entity. On this basis, for example, Canada would not deny treaty residence because in its home jurisdiction an entity is exempt from income tax (for example, a charity or pension fund), enjoys a territorial participation exemption, is able to consolidate its income with losses of an affiliated entity, or is able to pay no tax based on deductions for distributions to its members.[44] This kind of deference toward how a treaty partner chooses to tax income over which it exercises full taxing jurisdiction was demonstrated recently by the Tax Court of Canada in a

[43]*See* the technical interpretation, *supra* note 4.

[44]The decision of the Supreme Court of Canada in *The Queen v. Crown Forest Industries Limited*, 95 DTC 4389 (SCC) (''*Crown Forest*''), the leading Canadian case on tax treaty residence, is widely regarded as standing for the principle that a person will be considered ''liable to tax'' for purposes of determining whether the person is a resident of one of Canada's treaty partners under an applicable tax treaty in which the person is liable to the most comprehensive form of taxation imposed by that state (that is, where the state asserts its general taxing jurisdiction regarding that person), without regard to any aspects of the particular tax regime to which the person is actually subject under the relevant domestic law. In Income Tax Technical News No. 35 (Feb. 26, 2007) (ITTN No. 35), the CRA accepted the *Crown Forest* decision and stated that, on the basis of that decision, the CRA will generally accept that a person is a resident of the other contracting state even in ''situations where a person's worldwide income is subject to a contracting state's full taxing jurisdiction but that state's domestic law does not levy tax on a person's taxable income or taxes it at low rates.'' In a recently published administrative view, CRA document no. 2007-0261551I7 (Oct. 19, 2010), the CRA also followed its position in ITTN No. 35 regarding the treaty residency of taxpayers that are subject to special foreign tax regimes. In that case, the CRA considered whether Barbados exempt insurance companies (EICs) are resident in Barbados for purposes of the tax treaty between Canada and Barbados, even though the maximum amount payable by an EIC as a tax in any given year regarding its exempt insurance activities is $5,000, and such tax benefits under the relevant Barbados legislation are guaranteed to an EIC as licensee for 30 years. The CRA held that EICs are resident in Barbados for treaty purposes. Thus, both the *Crown Forest* decision and the related CRA administrative policy respect the allocation of taxing jurisdiction under tax treaties in not making the availability of treaty benefits dependent on how Canada's foreign treaty partner chooses to tax a person that falls within its taxing jurisdiction.

different context. In *TD Securities (USA) LLC v. The Queen*, 2010 DTC 1137, the court held that a fiscally transparent U.S. limited liability company, whose income was subject to U.S. tax in the hands of its U.S. resident corporate sole shareholder, was a ''resident'' of the United States. In support of its conclusion, the court stated:

> Canada gets to choose who to tax under the Canadian Act, a US LLC or its members, a partnership or its partners. However, when deciding how to apply its international convention with its treaty partner, Canada must consider as part of the context that the US also gets to choose at which level to impose its domestic tax under the US Code on that income, partnership or partner, LLC or member. . . . It makes little sense to think that treaty entitlement should be affected by a US LLC's exercise of its right under the US Code to elect to have its income taxed in its hands or flowed through and taxed in the hands of its US resident members.[45]

Analogously, once a particular payment by a hybrid entity satisfies the same treatment test, such that the U.S. has recognized the payment as income and thus Article IV(7)(b) does not apply to it, it makes little sense for Canada to then argue that treaty benefits should nonetheless be denied as a result of the actual or notional interaction of the payment with distantly related U.S. tax rules or elections (for example, the check-the-box election for an underlying reverse hybrid entity that is neither the recipient nor payer of the income item in question). Once the United States decides to include a Canadian-source payment in income of a U.S. resident (in a manner that satisfies the same treatment test in Article IV(7)(b)) it would not seem to be the task of the GAAR as applied to the treaty to intrude further and make treaty relief depend on how the Canadian-source payment interacts with other U.S. tax items.

Also, the GAAR is itself not designed to give determinative weight to the presence or absence of foreign tax avoidance. Rather, as noted, it applies, in very general terms, when a taxpayer has undertaken abusive tax avoidance resulting in a tax benefit, which is defined as a benefit *under the ITA* and not under foreign tax laws. Thus, the provisions of the GAAR are clearly geared toward identifying and then rectifying only Canadian tax avoidance, such that U.S. tax avoidance would generally not be relevant to applying the GAAR. Accordingly, in applying the GAAR to an Article IV(7)(b) workaround transaction, although it is appropriate to take into account foreign tax minimization to the limited extent described above, it is equally important that the GAAR analysis be done within the parameters of that statutory rule, which are strictly bounded by Canadian tax minimization concerns. What the particular outcome is under the DCL rules therefore should not matter to the application of the GAAR.

If, however, the DCL rules are to be taken into consideration at all in determining whether to apply the GAAR to Article IV(7)(b) workaround transactions, their existence should weigh in favor of not applying the GAAR to such transactions. As noted, under the DCL rules, when a ULC has a net operating loss in a particular year in a situation such as ABA example 2, the DCL rules will generally deny a U.S. tax deduction in that year to the extent of the resulting DCL. Thus, the DCL rules are targeted at the very form of U.S. tax avoidance regarding which the CRA expressed concern at the ABA panel discussion (that is, the use of a non-U.S. reverse hybrid that does not distribute earnings and profits currently, combined with holding such reverse hybrid through a ULC that generates a U.S. interest deduction), and the DCL rules eliminate or limit the U.S. tax benefit that would otherwise result in such situations. Accordingly, if the CRA were to apply the GAAR to an Article IV(7)(b) workaround transaction such as ABA example 2, this would involve the CRA policing precisely the U.S. tax avoidance at which the DCL rules themselves are aimed and effectively eliminate. In any event, even if the application of the DCL rules did not completely eliminate the U.S. tax benefit otherwise resulting from such avoidance transactions, it would nevertheless be inappropriate for the CRA to use the GAAR to address a form of U.S. tax avoidance that the U.S. already polices with its own regime (that is, the DCL rules).

It may be that the CRA would agree with the comments offered here, or that its views regarding the relevance of the DCL rules in a GAAR analysis are not settled. What is evident is that consideration of those rules seems at least to be working its way into discussions of the application of the GAAR to Article IV(7)(b) workarounds. What is less evident, however, is whether, in order to determine whether Canada should be granting treaty benefits to U.S. residents, any of Article IV(7)(b), the GAAR, or indeed the CRA's own tax auditors are equipped to factor into the analysis complex rules applicable to the minimization of U.S. tax that have no immediate or direct impact on the U.S. tax treatment of the income item being tested under Article IV(7)(b). ◆

[45] *TD Securities*, at para. 98.