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Proposed General Anti-treaty Shopping Rule : Private Investment Funds Will Need to Play it Safe

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LAVERY: A LEADER IN MONTREAL IN THE PRIVATE EQUITY, VENTURE CAPITAL AND INVESTMENT MANAGEMENT INDUSTRY

Creating and setting up private equity and venture capital funds are complex initiatives requiring specialized legal resources. There are very few law firms offering such services in Quebec. Lavery has developed enviable expertise in this industry by working closely with promoters to set up such structures in Canada and, in some cases, the United States and Europe, in conjunction with local firms. Through Lavery's strong record of achievements, the firm sets itself apart in the legal services market by actively supporting promoters, managers, investors, businesses and other partners involved in the various stages of the implementation and deployment of private equity and venture capital initiatives.

Following the recent public consultations held by the federal government on the issue of treaty shopping, the 2014 Budget proposes to implement in the Canadian domestic law a general anti-treaty shopping rule ("**GATSR**") which private investment funds investing in Canada ("**Funds**") may have to deal with.

Treaty shopping refers to a situation where, for example, a non-resident person who is not entitled to benefits under a Canadian tax treaty uses an entity in a country with which Canada has concluded a tax treaty and, to obtain Canadian tax benefits, earns or realizes income sourced in Canada indirectly through that entity.

The GATSR would probably be integrated into the *Income Tax Conventions Interpretation Act*. Its application would result in denying in whole or in part the benefits claimed pursuant to a tax treaty.

The GATSR provisions would provide for the following items:

Main purpose provision: Subject to the relieving provision, the purpose of the GATSR would be to deny the benefit of a tax treaty to a person where it is reasonable to conclude that one of the main purposes of the transaction or series of transactions is to allow that person to obtain the benefit.

Conduit entity's rebuttable presumption: It would be presumed that one of the main purposes of the transaction or series of transactions is to obtain a benefit pursuant to such a treaty if the income in question is primarily used to pay, directly or indirectly, an amount to another person (such as a limited partner of a Fund) who would not have been entitled to an equivalent or more favourable benefit had that person received directly the income in question.

Safe harbour's rebuttable presumption: Subject to the rebuttable presumption of use of a conduit entity, it would be presumed that none of the main purposes for undertaking a transaction was for someone to obtain a benefit under a tax treaty if, as the case may be:

- the person carries on an active business, <u>other than managing investments</u>, in the foreign treaty country and, where the income in question is derived from a related person in Canada, the active business is substantial compared to the activity carried on in Canada by such related person;
- the person is not controlled, *de jure or de facto*, by another person who would not have been entitled to the benefit had that person directly received the income in question;
- the person is a corporation or trust listed on a recognized stock exchange.

Relieving provision: The Minister of National Revenue ("Minister") would, at his discretion, allow the grant of the benefit, in whole or in part, when circumstances reasonably justify it.

Some examples of application of the GATSR suggest that a Fund may be targeted by the new rule. A fund which is set up as a limited partnership generally relies on a holding corporation which may be considered by the Minister as a conduit corporation pursuant to the GATSR. Funds should not assume that the legislator will provide relieving transitional rules for current structures, but rather consider right now the implementation of mechanisms to avoid or reduce the effects of the GATSR.