David Rosenbloom Testifies Before the Canadian Parliament on Proposed Tax Agreements

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Parliament of Canada, House of Commons Standing Committee on Finance

On June 17, 2013, H. David Rosenbloom was invited to appear before the Parliament of Canada, House of Commons Standing Committee on Finance, to testify about his thoughts concerning Bill S-17, which will implement agreements between Canada and various countries to help avoid double taxation and prevent tax evasion. Mr. Rosenbloom's comments focused on newly-proposed exchange of information provisions with Luxembourg and Switzerland, and the agreements with the intermediary jurisdictions, Poland and Hong Kong. Please see below to read Mr. Rosenbloom's full testimony.

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STANDING COMMITTEE ON FINANCE

HOUSE OF COMMONS

JUNE 17, 2013

STATEMENT OF H. DAVID ROSENBLOOM
IN REGARD TO BILL S-17

My name is H. David Rosenbloom. I am a tax attorney and a professor of tax law. My area of specialization is international, or cross-border, taxation. I am a member of Caplin & Drysdale, Chartered, a U.S. law firm, and the Director of the International Tax Program at New York University School of Law in New York City. In the late 1970s I was the International Tax Counsel in the United States Treasury Department and, in that capacity, I was the chief U.S. negotiator of the 1980 Income Tax Convention Between Canada and the United States.

I thank the Committee for this opportunity to offer observations on Bill S 17, an act to implement Conventions, a Protocol, and an Agreement between Canada and various countries. All of these agreements are for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes.

My comments are necessarily constrained both by my relative unfamiliarity with Canada's tax treaty policies and by the extremely brief amount of time I have been able to devote to a study of the Bill. I am not a Canadian tax expert, and I was unaware of the Bill prior to the afternoon of June 14.

Furthermore, I have not been informed regarding the specific aspects of the Bill on which I am asked to comment. My working assumption is that the Committee may be most interested not in the new Conventions with Namibia and Serbia, parts 1 and 2 of Bill S 17, but rather with the Convention with Poland and the Agreement with Hong Kong, Parts 3 and 4, and with the Protocol to the existing Convention with Luxembourg, Part 5, and the Supplementary Convention with Switzerland, Part 6. These last two parts deal with the subject of information exchange. Parts 3 and 4, on the other hand, are a Convention and an Agreement with jurisdictions (Poland and Hong Kong) that have been used by investors from other countries to invest outside those jurisdictions.

I thus confine these initial comments to the newly proposed exchange of information provisions with Luxembourg and Switzerland, and the agreements with the intermediary jurisdictions, Poland and Hong Kong.

The Protocol to the Convention with Luxembourg appears consistent both with current practice of the Organisation for Economic Co operation and Development and the pending Protocol to the Income Tax Convention between the United States and Luxembourg. There are some differences among these texts, but they are of a technical nature and, I assume, of relatively little interest to the Committee. I have some reservations about the efficacy of such provisions for achieving useful information exchange, but I cannot see that they do any harm.

The Supplemental Convention with Switzerland, on the other hand, relieves a requesting country from the need to provide a specific name to the requested country in order to obtain information about a person and in order to identify the person in possession of that information. Since the requesting country is often in need of the name — that is the reason for the request in the first place — a requirement that the name be given in order to obtain the requested information might often render the information exchange provision nugatory. Thus, this Supplementary Convention responds to a real problem, and despite my abiding skepticism about information exchange via tax convention, I can see no substantial objection to it.

The Agreement with Hong Kong and the new Convention with Poland are a different, and much larger and more complicated, matter. A major concern with jurisdictions that lend themselves (and their treaty networks) to investors from elsewhere is the possibility that their conventions became, in effect, agreements with the entire world. In the United States we think most tax conventions are bilateral in nature and that the benefits they confer should be confined to persons with a genuine connection with one of the treaty partners.

One means of implementing this policy is simply not to enter into conventions with jurisdictions that serve as intermediaries, especially if there is no demonstration of a genuine risk of double taxation. Regrettably, the United States has not always followed this route. We have, for example, conventions with Bermuda, Cyprus, and Barbados, to name but three examples of jurisdictions where the need for a U.S. tax convention would not appear compelling.

Apart from the strategy of not negotiating conventions with certain jurisdictions, the United States relies on certain measures both within the text of its conventions and drawn from general jurisprudence to combat treaty shopping. A Limitation on Benefits article requiring a genuine nexus between the party claiming benefits and the treaty partner is now standard in all modern U.S. tax conventions. And the economic substance doctrine, recently enacted into U.S. statutory law but of lengthy vintage in our courts, has served as a potent weapon against at least some types of treaty shopping.

I note that paragraph 3 of Article 26 of both the Convention with Poland and the Agreement with Hong Kong represents an abbreviated version of what has become, in the United States, the Limitation on Benefits article. The Article 26 provision, which also appears in the Conventions with Namibia and Serbia, effectively precludes foreign owned entities from enjoying a more beneficial regime in the treaty partner than domestically owned entities. This is where early versions of the U.S. Limitation on Benefits provision began, but the provision has since gone much further. Whether it has always been effective is an open question.

I conclude by citing a provision of this type that actually seems to work. It appears in the U.S. Convention with Cyprus, and contains two substantive rules of general relevance: first, that U.S. benefits are available only to

Cypriot entities that are owned to a large extent (both legally and economically) by genuine individual residents of Cyprus or, in some limited circumstances, by citizens of the United States; and second, that such benefits are allowed when it is determined on a discretionary basis that the establishment, acquisition, and maintenance of the entity and the conduct of its operations did not have as a principal purpose obtaining benefits under the Convention. The provision is general and, some might say, unacceptably vague. Yet for that very reason it seems to have succeeded in thwarting attempts by third-country investors to use the Cyprus Convention to obtain inappropriate treaty benefits in the United States.

I will be happy to respond to any questions the Committee may have.

Attorneys

H. David Rosenbloom

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