

LAW 599 (Y1)

INTERNATIONAL
TAXATION

Sommerfeldt

I. INTRODUCTION TO INTERNATIONAL TAXATION

ITA, s. 248(1) “non-resident”, 250.1

FCIT, p. 91-94, 113-114, 1299-1300, 1331-1333, 1393-1394

No authoritative body imposes a tax on international level (UN levies duties, not taxes); no such thing as an international law on taxation. Tf, focus only on Cdn authoritative body; only law developed in Canada laterally or bilaterally (treaty). Multilateral treaties, but not with tax (at least with Canada). Focus Canada-US Treaty. Cross-border: Cdn TP outside Canada or NR some connection to Canada. ITA also has Conventions sections. Geneva tax law but no international tax body makes tax law per se. Sovereign countries, either alone or via bilateral or multilateral treaties, make international tax. OECD (Organization of Economic C? Development) model tax treaty, but is nothing more than a model; has nor force of law and not required to use it (can use all, some, or none of provisions).

International taxation: way a particular country taxes transactions that have an international taxation component. Still generally accepted international tax principles.

1. Every country has the right to tax bc country a sovereign entity. Jurisdiction issue in way taxes can be levied: physical location of ind (residence), domicile (UK), ppty location (e.g. rental ppty), where company incorporated, source of income, citizenship (US), place of mgmt.
2. Most countries focus their tax rules on people they call subjects (residents, citizens, business entities governed by country’s laws). But now easy for NRs to derive income from that country so look for way to tax NRs; NRs of their country may be taxed in another country bc many tax their residents on their worldwide income.
3. When taxing NRs, most countries try to limit their tax only on income somehow sourced in their country. If live and work in Canada, peculiar England tax income earned in Canada. However, if \$ in French bank, France may want to tax that income.
4. Some countries deliberately choose not to tax entities (or very low tax) whose economic owners are NRs (“**tax havens**”). Have other revenue sources or operate on volume basis. Often normal rates against normal resident but lure NRs to do business there. Also lawyers, accountants, etc. Example: Cayman Islands banking industry. Often charge non-tax fees, e.g. incorporation fees (not enormous but source of revenue). Tax economy drives their local country. TPs in industrialized countries don’t like taxes so try put investment income where no tax. If decent return rate and 0% tax and not taxed until bring \$ back, happy. But Canada since 1970: “Foreign Accrual Property Income” FAPI: If someone in Canada has ppty (investment) income accruing outside Canada (usually Holdco or trust) in tax haven, even if \$ not paid back (merely accrued), must include it in their income on their Cdn tax return. FAPI modelled from US rules (Subpart F).

5. Most countries recognized desirability of not having double taxation. If both tax particular income stream, nothing left for investor and both economies suffer (“flight of capital”). Delicate balance: must generate income to fund their programs but if tax too much people with \$ will go elsewhere. Canada only has bilateral treaties; treaty partners generally help each other counter tax avoidance (exchange of info) (e.g. if things in Canada may constitute tax evasion in US, IRA may be able to get info from CRA).

Apply treaty: (1) Is particular TP actually subject to tax in both countries? If only taxed in one, treaty may not have any application; (2) Is particular item of income or capital actually covered by treaty? Treaty may be silent on that particular type of income.

6. Most industrialized countries’ treaties concept of carrying on business and PE. If someone carrying on business in their country, generally think subject to tax. US different jargon: foreign being engaged in a trade or business and limit tax to income that is effectively connected to that trade or business. Canada uses term carrying on business in Canada. Case where NR adventure in the nature of trade – Ct said not carrying on business. Most treaties provide business income earned by NR taxed only if carrying on business AND attributable to a PE.

7. Characterization of income. Generally, 2 broad categories: (1) Active (business or employment) income; (2) Passive (investment) income. Treated differently in domestic tax leg’n and treaties. Business: sale of goods, services, or right to use something (3 types of business income can be treated differently in treaty provisions). Need to properly identify type of income. If PE, passive 25%; if active or business, Part I.

Sources of tax law in Canada as to international transactions: ITA, Cases, Treaties. IT Regulations, ITA Conventions and Leg’n. Really ITA, Jurisprudence, and Treaties.

248(1): “Non-resident”: “means not resident in Canada”.

250.1: Unless context (specific rule) requires otherwise, for purposes of our ITA:
(a) NR’s taxation year determined in same manner as the taxation year of a Cdn resident.
(b) Cdn parent when determining income may have to take into account subs outside Canada: “a person for whom income for a taxation year is determined in accordance with this Act includes a NR.”

Many countries tax their residents on their worldwide income. Canada does this in 2(1) (doesn’t exactly say that). 2(3): NR liable for tax in Canada if:

- (a) was employed in Canada.
- (b) carried on a business in Canada, or
- (c) disposed of a taxable Cdn property.

DS: Levying tax only wrt Part I (major portion). Part XXV: levy special types of taxes. If just invest in Canada, taxed under Part III, not Part I. Generally if taxed under Part I, NR must file tax return (slightly different); graduated rates and no prov’l abatement (prov doesn’t tax bc in constitution, can’t tax outside province). If investment income under

Part III, if someone employed, doing business, or selling property, gov't can enforce tax via garnishee (if still working). Gov't withholding tax to collect bc hard to enforce.

II. CANADA'S NETWORK OF TAX TREATIES

ITA, s. 81(1)(a), 110(1)(f)(i), 115.1(1), 150(1)(a)(ii), 248(1) "tax treaty", 250(1)(g), (5)
Can-US Treaty, Articles I-VII, IX-XV, XXIV-XXVII (skim)
FCIT, p. 109-111, 1715

Process: 2 countries decide if want treaty with one another. Send bureaucrats (Department of Finance) to negotiate treaties. Most treaties quite standard so need to negotiate points of difference. Reach agreement, get someone with signing authority to sign agreement. Generally call them tax treaties, but formal name is international conventions. Once signed by authorized gov't representatives, must be ratified by 2 countries. Cdn ratification process requires enactment of statute in Parliament; still need ratification process in other country. In US, executive branch (President) makes treaties, but Senate authority to ratify. Once formally ratify, still not effective. Must exchange instruments of ratification and usually provide treaty will come into effect on a particular date. In some cases, if treaty really beneficial for TPs, retroactive (but usually forward looking). Signed but not in force: process of negotiating or re-negotiating.

P 2375: 85 treaties. Some signed but not in force. Italy signed but not in force (but on first page): new treaties will replace olds. Canada may deliberately choose not to have tax treaties with tax havens. Most Treaty provisions follow OECD Model, but planning looks at exception to general rule and using it to one's advantage.

248(1) "tax treaty": Nothing profound. Have not replaced "convention" term. "a comprehensive agreement or convention for the elimination of double taxation on income, between the gov't of Canada and the gov't of the country, which has the force of law in Canada at that time."

115.1(1): Contrary to Financial Administration Act for CRA to settle; must try collect any dollar of tax properly payable (can dispute facts though). 115.1(1): Taxing authorities find resolution called "competent authorities": CRA and other senior tax authorities in other country may reach an agreement. If Treaty and Act inconsistent, then any reached agreement is deemed in accordance (consistent) with ITA. Not a forgiveness of tax that would be contrary to Financial Administration Act.

110(1)(f)(i): "deductions for payments": (i) "an amount exempt from income tax in Canada because of a tax treaty". 110(1) preamble: "for purpose of computing taxable income of a TP, the following items might be deducted". DS: Income = revenue – expenses = profit. Can subtract s. 110 deductions to get to taxable income, which includes an amount exempt from Treaty (an income tax provision must recognize this exemption?). Tax rate applied to taxable income. Social assistance payments now under 110 deductions (before deducted above). Other provisions on syllabus, but need not look at them (just some provisions where treaty factors into Act).

Treaty: Articles, I-VII, IX-XV, XXIV-XXVII (skim for flavour).

Canada-US Tax Convention (1980). True title below (very long). For exam, call it the Canada-US Treaty.

Preamble for purpose of treaty: (1) Avoidance of double taxation; and (2) Prevention of fiscal evasion wrt taxes on income and capital.

Article III: General Definitions: Only 10 defined terms!

Article IV: Residence: Anyone who comes within treaty terms will really only end up with one residence.

Article V: PE.

Article VI: Income from Real Property: Canada in Treaties quite jealous real ppty income taxation. Not much tax breaks for income from real ppty that leaves Canada.

Article VII: Business profits: Limitation to tax business profits (other way of saying income from carrying on a business).

Articles X, XI, XII: Main provisions that reduce withholding tax on dividends, interest, royalties (3 main investment income sources)

Article XIII: Taxation of gains (taxable gains)

Articles XIV: Independent Personal Services (people in business)

Articles XV: Dependent Personal Services (employment income)

XXIV: Elimination of Double Taxation (tax credits). XXV: Non-Discrimination.

VK: Concern of improper use of tax treaties (“treaty shopping”). E.g. XXIX(A) limits benefits of the treaty to “qualifying persons”, a phrase that Treaty defines restrictively. Also allows authorities to deny benefits of Treaty if abusive manner. Can provide “look-through” provisions to disallow Treaty benefits.

III. PRINCIPLES OF TAX TREATY INTERPRETATION

Income Tax Conventions Interpretation Act, s. 1-4.1

Vienna Convention on the Law of Treaties, Articles 31-32

Crown Forest [1995] SCC

Coblentz [1996] FCA

Kubicek Estate [1997] FCA

Renz [2003] TCC

FCIT, p. 74

Treaties not really statutes, so principles in treaty interpretation not necessarily the same.

Income Tax Conventions Interpretation Act (P 2287):

S. 3: Meaning of undefined terms: If term is undefined in the Treaty, its meaning is derived from the ITA as amended from time to time, and NOT the meaning it had under the ITA at the time it was signed if its meaning, after it was signed, it changed in the ITA.

Notes: S. 3 was introduced to overrule **Melford Developments** [1982] SCC.

F: Germany had guaranteed the loan that M borrowed. M argued it was exempt bc when Treaty signed, guarantee fees were not deemed to be interest.

Ratio: SCC: An undefined term is to be interpreted as having the meaning it had under the ITA at the time the convention was adopted. Treaty static once signed; only way to amend is to get consent from other country (cannot amend unilaterally). **VK:** Thinks SCC wrong; thinks Treaty is a living, breathing document so when domestic leg'n changes, so too does Treaty. **DS:** Unsure if s. 3 would change the result. Says guarantee deemed interest. Does it change def'n of interest or just a deeming rule that doesn't effect meaning of interest. Thinks can argue both ways.

S. 4.1: Application of s. 245 of the ITA (GAAR): If TP does something to acquire taxable benefit, tax authorities can reassess to deny that benefit, unless valid purpose other than tax avoidance. GAAR doesn't apply unless misuse or abuse of Act. If artificial transactions to get Treaty benefit, GAAR applicable.

Crown Forest Industries [1995] SCC *Only know US rules to understand Cdn application.

F: N incorporated in non-US tax haven. IRC 2 types of corps: domestic (created in US) or foreign (any corporation not domestic). Domestic taxed by US on worldwide income. Foreign corp if "engaged in trade or business in the US", subject to US tax but only to the extent of income that is "effectively connected with the conduct of the trade or business in the US". In Canada, catch-phrase is "carrying on business in Canada". Case for (1) Interpretation of tax treaties; (2) Residence of corporations. I: Was N a resident of US for purposes of the treaty. ME: N's tax liability was derived from the IRC, s. 882 which provides that a foreign corporation (N) *engaged in a trade or business within the US* shall be taxed in the same manner as a US corporation *only on that portion of its taxable income which is effectively connected with the conduct of its US trade or business* (must meet both italicized portions for a foreign corp'n to be taxable).

Ratio: Treaty Interpretation:

Paramount goal in interpreting a treaty is to find the meaning of the words in question. This process involves looking to plain language used and intentions of the parties. [US intervened with intention bc N using US as tax haven].

Plain Language (Meaning) Rule:

DS: Look at what words say; limited to the statute. Cannot use Hansard if gov't sloppy.
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ME: “Engaged in a trade or business” is not a factor listed in Article IV so would have to be a “similar criterion” to trigger residency for purposes of the Treaty. IF, rather, tax liability emanates from “place of management”, this is a sufficient condition of residence under Article IV. Under Article IV, it must be shown that liability to taxation operates *by reason of* one of the listed grounds. Thus, place of management alone is not determinative. SCC: Connotes a causal connection or relationship of proximity. Here, place of management not connected at all to N’s tax liability, but rather bc income flowing from the business or trade is conducted that was connected to the US via s. 882 or IRC. D: “Engaged in a business in the US” not a similar criteria. Similar criteria on those that impose full tax liability on worldwide income. S. 882 merely amounts to source liability.

Intention of the drafters of the Convention:

ME: Contrary to an ordinary taxing statute, a tax treaty or convention must be given a liberal interpretation with a view to *implementing the true intentions of the parties*. A literal interpretation must be avoided when the basic object of the treaty might be defeated or frustrated. Ct may refer to extrinsic materials which form part of the legal context (these include accepted model conventions and official commentaries thereon) without the need first to find an ambiguity before turning to such materials. SCC: Convention intended to benefit Cdns working in US (or vice versa) and Cdn companies operating in US (and vice versa) to promote international trade between Canada and US, to spare such individuals and corporations double taxation. Here, no need to prevent double taxation. N’s plan designed to avoid tax. Convention’s purpose not to permit companies incorporated in a 3P country (the Bahamas) to benefit from a reduced tax liability on source income merely by virtue of dealing with a Cdn company through an office situated in the US; no way Canada entered into a Treaty with US to essentially cede its taxing authority to a stranger of the Convention, namely Bahamas.

Crown Example: Foreign corporation earns \$100 ‘effectively connected income’ and \$1,000,000 of foreign source ‘non-connected income’. Thus, bc \$100, now US resident under Article IV bc liable to pay tax on \$100, but benefit from Convention wrt \$1,000,000 even though US declines to tax that income. “treaty shopping”: availing themselves of benefits designed to be given only to ‘residents’ of the contracting states. SCC: Can look at extrinsic materials, such as other international taxation conventions and general models to help illustrate the intentions of parties to Canada-US Income Tax Convention. Articles 31 and 32 principles of Vienna Convention on Law of Treaties applicable. OECD Model is highly persuasive in terms of defining Canada-US Treaty’s parameters. It has same intro as Article IV but adds “but this term does not include any person liable to tax in that state in respect only of income from sources in that state or capital situated therein.” Does not form part of the Canada-US Convention, but really relates to a person exempt from worldwide taxation bc of a special privilege like a foreign diplomatic, but we normally do not have these. *Commentaries to the OECD Model Convention as well as academic sources indicate that generally domestic laws of contracting states employ residence to apply on “full-tax liability”.

Article I: Personal Scope: Treaty generally applies to persons who are residents of one or both of the Contracting States.

Technical Explanation [1984]: Language in fine print below Articles. US Department of Treasury wrote what they think Treaty says. Some verbatim, some slant (clarifying). News release by Cdn Department of Finance on Aug. 16/84 appeared appears to adopt the US technical explanation, until Canada reassessed a couple TPs.

Coblentz [1996] FCA (not read): Ratio: Technical Explanation may be accepted as valid guidance by the Courts. DS: Ct did not go as far to pronounce authoritatively how strongly one may rely on the Technical Explanation.

Kubicek Estate [1997] FCA (not read): Ratio: The Technical Explanation is a domestic American document. True, it is stated to have the endorsement of the Cdn Minister of Finance, but in order to bind Canada, it would have to amount to another convention, which it does not. From the Cdn viewpoint, it has about the same status as a Revenue Canada interpretation bulletin, which is of interest to a Court but is not necessarily decisive of an issue. DS: Said technical explanation not binding, so CRA need not follow it. Indication technical explanation isn't necessarily all that authoritative.

Summary: **Crown Forest** says party's intention of treaty relevant. Will listen and accept if US intervenes to tell us their interpretation. **Kubicek:** said TP cannot rely on the Technical Explanation. CRA said forget party's intentions. Almost a full circle. Is party's intentions to treaty relevant or not?

Renz [2003] TCC (informal)

F: TP, US citizen resident in Canada (EE), paid interest on US student loans. Tried to claim student loan interest credit bc of his residence in Canada in 1998.

I: Can TP claim tax credit pursuant to section 118.62 of the ITA? D: No.

Ratio: NAFTA argument irrelevant for us (NAFTA dispute resolution exhaustive). Article XXV of Treaty, non-discrimination, para. 1. DS agrees with Ct. Even if Cdn resident and anything other than 118.62 programs, can't deduct (e.g. line of credit). No distinction created by 118.62 between Cdn and US citizens.

20(10): Notwithstanding 18(1)(b) [can't deduct capital], can deduct expenses incurred by attending, in connection with the business, not > 2 conventions held at a location that may reasonably be regarded as consistent with the territorial scope of that organization. I: US convention fall there?

Article XXV, para. 9: Expenses incurred by Cdn resident wrt any convention held in US shall for the purposes of taxation in Canada be deductible to the same extent as if convention were held in Canada.

Wrinkle: CRA: IT-131R2: Treaty expands parameters of territorial scope from Canada to US, but organization must still have geographic parameters consistent with that organization. E.g. AB dentistry in PEI. No, beyond territory. CRA: Need national presence (e.g. CBA allowed to hold Convention in US and get deductibility). Not looking at business of particular person who is attending. CRA: 20(10) not intended to stop someone from going to PEI for expert meeting. Skill that can apply anywhere. AB lawyer could get as much of a benefit from PEI convention as anyone else.

IV. RESIDENCE

A. INDIVIDUALS

ITA, s. 2, 250(1)-(3), (5), 253

Can-US Treaty, Article IV, ¶ 1-2, 5

Thomson [1946] SCC

Wolf [2001] TCC; rev'd on other grounds.

Allchin [2005] TCC

Interpretation Bulletin IT-221R3 - Determination of an Individual's Residence Status FCIT, p. 91-103

Cdn resident taxed on worldwide.

Term "residence" not completely defined in ITA, so must turn to CL (250 rule deems people residence, but doesn't say what residency mean). 250, CL, Treaty.

250(1)(a): "sojourning rule": deemed resident of Canada if sojourn for 183 days. Need not be consecutive. Part days count. (b) through (h): If work for someone connected to gov't (soldier, diplomat) and bc of empty posted overseas, deemed resident of Canada. Sprysak: Can be present in Canada but not sojourning: Commuting to Canada to work but return each night to normal residence in US. VK: If so, taxed on worldwide income for entire yr. *Ind. cannot, however, be deemed to be resident in Canada by virtue of 250(1) if considered resident in Canada by CL rules. See def'n for sojourn. Not automatically considered sojourning in Canada every day or part day present in Canada; must look at nature of each particular stay separately (IT-221R3). Vacation in Canada is sojourning.

250(3): resident includes "ordinarily resident".

Thomson [1946] SCC

F: T, Cdn citizen, wanted Bermuda resident status; affidavit, home but never used, Bermuda passport. Spent summers in Canada. Went much time in US.

D: Resident of Canada. No Treaty at time. Now, quickly determine if residency in both countries and go back to Treaty tie-breaker rules. Most cases on residences always cite **Thompson** principles.

1. Person may be resident in more than one country (Kerin).
2. Must be resident somewhere (Rand). Case with sailors, and found them to be residence.
3. Ordinary residence was whole strip on Atlantic seaboard (Rand). Can a person be ordinarily resident in two countries?
4. Residence a **question of fact** (Rand), so impossible to give it a precise def'n ("has many shades of meaning). No one fact determinative.

Ordinarily resident broader or narrower than residence?

1. Ordinarily resident is broader than the word residing (Taschereau).
2. Ordinarily resident carries a restrictive signification (Rand). Means general and customary mode of life, rather than special or occasional visit.
3. Didn't see a need to discuss distinction bc found T both resident and ordinarily resident. Said that if no case would a different, might be superfluous language (Kerwin).
4. Estey: one is ordinarily resident in a place where in the settled routine of his life, he normally, regularly, and customarily lives. Settled routine: Look over longer period rather than narrow period as a student. **Compare:** sojourn where he unusually, casually, or intermittently visits or stays (vacation, business trips). In former, permanence emanates; in latter, temporary. Length of stay does not determinative.

DS: Ordinarily resident is normally intended to catch a situation where go to UK for school work and decide to come back. While resident in UK, still ordinarily resident here.

ME: Ordinary dictionary def'n: matter of regular occurrence, casually, usually, commonly. ME: IT-221R3: Cts have held "residence" to be "a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests, and conveniences at or in the place in question."

Article IV, para. 1: "For the purposes of the Treaty, term 'resident of a contracting state' means any person that, under the laws of that State, is **liable to tax** therein by reason of that person's domicile, residence, citizenship...or any other criteria of a similar nature." Only applies for purposes of the Treaty; does not define resident for ITA purposes (but see later some bearing). Critical: If not liable to tax, not a resident for the Treaty. DS: "Liable to tax" means that if had income, would have to pay tax on it.

Tie-breaker rules. OECD model slightly different (see in Allchin). Article IV only determines resident for purposes of the Treaty. Look to other provisions of Treaty for relief. Simple fact you're resident of US does not itself give relief; must be another provision that specifies relief.

Tie Breaker Rules: Article IV, para. 2: Where by reason of paragraph 1, an individual is resident in both Contracting States, then his status will be determined as follows:

Through rules consecutively;

1. **Location of permanent home** (available for use). Rather than intending a short duration. **IT-221R3: Can mean any type of dwelling.** Doesn't matter if buy or rent. Allchin TCC: CRA view more expansive than Commentary.

2. **Centre of vital interests:** personal or economic interests closer (family, social, occupation, political/cultural activities, place of business, and place of administration of property).
3. **Habitual abode.** Spend most time (without reason for stay). ??
4. **Nationality** (citizenship).
5. **Competent authorities** to settle question by mutual agreement [CRA].

250(5): Notwithstanding any other provision in this Act, a person deemed not to be resident in Canada under the Treaty (even if resident of Canada, but for Treaty), then NR for all purposes of the ITA. Applies to individuals and corporations. DS: Were claiming NR status for Treaty benefits, and resident status under domestic Act for other purpose.

Allchin [2005] TCC

F: Left employment in a hospital in Ont, but still significant ties to Ont. (phone line). Had green card in US and lived in US. Minister reassessed arguing she had not severed her Cdn ties. At first trial, TJ found resident in Canada but didn't consider if resident of US. FCA: Fundamental error bc might be US resident.

TCC: Since "green card" (for immigration purpose, can go into US as permanent resident), resident under US domestic leg'n so eligible for tiebreaker rules.

TCC: 1. Permanent home both (access to friend's condo in US). ***ME: No, TCC oddly said had a permanent home in both or neither.** 2. Centre of vital interests in both; personal relations in Canada but economic relations in US (many facts). 3. Habitual abode: Counted days in chart but added E wrt nature of TP's lifestyle in US. 100 days in Canada, 265 in US. Considered BOTH days and lifestyle.

D: Habitual abode in US. Tf, under Treaty, NR in Canada so TP wins.

DS Analysis:

1. Dictionary meaning of what habitual means: fixed by habit, constantly repeated or continued, or usual or constant or continual. Could you argue she constantly or usually went back to Canada every weekend? Could maybe argue she had a habitual abode in Canada. He did seem to put a fair bit of emphasis on the number of days.
2. Bell did not observe OECD commentary, which has different rule. US Treaty: if permanent home in both, next step is centre of vital interest, then habitual abode. OECD: if permanent home in neither, go right to habitual abode. TCC: Bc tests not the same, wouldn't use commentary. However, OECD commentary states you look at number of days when determining habitual abode.
3. FCA spends much time on determining whether holding green card is a criteria of a similar nature. TCC quoted this. DS: FCA wrong when say green card a similar nature; under US law, green card status is residence. Ct is just a little off. **ME: See Treaty and**

the Technical Explanation beneath it. There seems to be a pre-condition to obtaining Treaty benefits. Mere existence of green card is not enough.

4. TCC quotes Crown Forest (para. 33) saying issue was whether respondent (Crown Forest) was a resident of Canada or of US. 2 problems: (1) Ct looking at different company (N) was resident in US; (2) Not whether a resident of Canada or US – only whether N was resident of US (never suggestion N was resident in Canada). Small, but are screw ups.

Wolf [2001] TCC; rev'd on other grounds.

F: TP, US citizen, employed as consulting engineer in Canada. TP paid directly by consulting firm's Cdn client. Rented his US residence. Minister declared him Cdn resident.

TCC: Only income from Canada. DS: No – bank accounts and credit cards. Didn't say at hotel; had apartment right by airport.

D: TP resident of both Canada and US by virtue of sojourn and citizenship, respectively. Found permanent home in both (inconsistent with saying only income in Canada). Found vital interests in US so NR for Cdn tax purposes.

Comments: Wolf in 2001; Allchin in 2005. Could use Allchin comments to argue there would be a different decision that in Wolf. Wolf did not distinguish between economic and personal interest (bc Judge would probably split them up). Also, more days in Canada so might argue different result.

IT-221R3: Merely principles announced by CRA. Normally persuasive in Ct, particularly if CRA trying to change its mind.

(a) Significant residential ties: dwelling place (house, boat, where normally sleep and eat), spouse or CL partner, and dependents. If single and no children, irrelevant. E.g. Skilled worker outside Canada, tough argument if leave wife and kids.

(b) Secondary ties: personal ppty (clothes, etc), social ties (clubs), economic ties (work, employment, credit cards, bank accounts), landed immigrant status, place of burial plot, Cdn passport, vehicle registered in Canada, medical insurance, post box, newspaper subscriptions, driver's licence, etc. CRA: Any secondary characteristic not in and of itself conclusive. E.g. If just leave bank account, then probably isn't too bad.

IT-221R3: If person physically outside Canada, CRA will look at (a) evidence of intention to permanently sever residential ties with Canada; (2) Regularity and length of visits to Canada; and (3) Residential ties outside Canada.

B. CORPORATIONS

ITA, s. 250(4)-(5.1), 253

Can-US Treaty, Article IV, ¶ 1, 3

Birmount Holdings [1978] FCA

Crown Forest [1995] SCC

Interpretation Bulletin IT-391R - Status of Corporations, ¶ 15-16
FCIT, p. 105-108

IT 391R – para. 15 and 16. 15 summarizes CL; 16 summarizes 250(4).

Corporation resident in Canada taxable on its worldwide income. NR corporations taxable in Canada only on their Canadian source income. Approach: 1. ITA 2. Common Law. 3. Tax Treaties.

S. 250(4) (“Bright-line test”) **corporation deemed resident for entire year (a) If incorporated in Canada after April 26, 1965 [regardless where CMC]**
(c) If incorporated prior to April 26, 1965, deemed to be resident only if, during any taxation year ending after April 26, 1965, it:

- i) Was resident in Canada under CL rules; or**
- ii) Ever carried on business in Canada (for that year and every year thereafter, consequences permanent). *253 extends meaning. These must happen AFTER 1965.**

Article IV, para. 1: Determine “resident for purposes of the Treaty”. Must be “liable to tax”. Crown Forest: means subject to tax on worldwide income...by reason of... residence, place of management, and place of incorporation or similar criteria. If any of these factors make you liable to worldwide income, resident of that country. If so, go to tiebreaker rules.

Para. 3: Tiebreaker: If resident in both US and Canada, then if created under laws of one country, deemed resident of that country. “Created”: **Incorporated**, but can it also be amalgamation? 1984 Technical Explanation: Says not how company organized; state of company’s original corporation. When amalgamation, company deemed to be new at law. Could argue if amalgamated, new company under Canada. Suppose took two companies incorporated in US, continue into Canada, and amalgamate: “created” in Canada? DS doesn’t know.

250(5.1): ITA deems a corporation that is continued into or outside Canada to have been incorporated in that jurisdiction and not incorporated anywhere else. (b) When apply (4), deemed to be incorporated in that jurisdiction after that point in time.

AB BCA: If AB continues outside AB, corporation continues under corporate law statute of other jurisdiction, but only if corporate law in other jurisdiction allows it to do so. If continues into AB, deemed incorporated in AB on date it continues in. Articles of continuation deemed to be articles of incorporation and certificate of continuation are deemed to be a certificate of incorporation. **Article IV, para. 3:** If continue into other country, deemed to be resident of that country. *Grey box: Finance setting out proposals since lawyers continues US corp’n into Canada; resident of Canada for Treaty but continue as US resident for domestic purposes; 2 countries made amendment; resident in one or the other, not both.

Birmount Holdings [1978] FCA *Relevant if not incorporated in Canada or if incorporated in Canada before 1965.

F: Get facts. B Ltd. incorporated B Ltd. in 1960 in Canada (before 1965). Head office and directors resided in Toronto, but beneficial owner in France (Greek citizen). D: CMC in Canada so B Ltd. a Cdn resident. Only discussed CL residence (not carrying on business). Unsure why not just access as NR carrying on business in Canada under 2(3).

Ration: Residence is a question of fact to be determined by looking at all of the circumstances.

De Beers Consolidated Mines [1906] HL: A corporation is resident where its real business is carried on, that is where the de facto “**central management and control**” is exercised [not through corporate capacity as through articles of incorporation]. Usually mgmt and control exists where the BOD meet and hold their meeting.

Unit Construction v. Bullock: Normally SHs residence irrelevant, but not in this case. UK parent effectively exercised dominion (through its directors, de facto) over wholly owned African incorporated subsidiary (directors resident in Africa). D: Sufficient to give UK residence to African sub. **Swedish Central Railway**: Corporation can have more than one residence if its CMC is located in more than one jurisdiction. Also, USA may put control in hands of SHs and take away from Ds (s. 146 of AB BCA).

Crown Forest [1995] SCC *Resident in either Canada or US for purposes of the Treaty

F: N incorporated in Bahamas but business in US. N considered a foreign corporation in US, but paid no tax bc of exemption for NR shippers. Crown Forest withheld 10% of rental payment arguing N had Treaty reduction (usually 25% as per 212(1)).

Issues: Whether N is a “resident of a contracting state” (in this case the US) within the meaning of **Article IV** of Treaty? **Article IV**: “resident of a contracting state” is “any person [or entity] who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature.” If yes, withholding rate reduced from 25% to 10% via Article XII.2.

Decision: Crown Forest loses –must pay 25% withholding tax to Canada. IRC: domestic corporation (incorporated in US) and foreign corporation (any corporation not a domestic corporation). Domestic: taxed on worldwide income. Foreign (N): taxed in US only if engaged in a trade or business in US and only income taxed is income effectively connected with that US trade or business. Effectively connected: look at where particular business in manage, so place of management is relevant.

I: N liable to any tax? It had effectively connected income, but particular IRC provision exemption for NR shipping company (so didn’t actually pay US tax). *When determining if TP liable for tax according to Canada-US Treaty, **means worldwide income** (whether right or wrong, SCC has spoken). Here, N not liable for worldwide income so cannot get \$ out of Canada into US at 10%.

Aside: Limited Liability Company (LLC) creature of US State law. More akin to partnership than incorporated company; members not SHs. But have SHs. But limited liability as though a corporation. US domestic tax law ignores them; income regarded as member's income not LLC (no tax return). IB bc no integration in US. Example: LLC owns all shares of AB corp and AB corp want to pay dividend to LLC. Treaty reduction? No. **IB and trips up people.** CRA: LLC resident in US for domestic purposes, but LLC not liable for tax in US so cannot be resident in US for purposes of the Treaty so no Treaty reduction. Often, US people get LLC to prescribe for shares of Cdn corp thinking 5%, but it is 25%. Tf, should use S-Corp. Parent owns 100% of S Corp (C Corp) shares who owns 100% of Opco (in Canada). Canada treats both as Cdn residents so get Treaty benefits.

C. TRUSTS AND ESTATES

ITA, s. 104(1)-(2), 250(5), (6.1)

Can-US Treaty, Article IV, ¶ 1, 4

Thibodeau Family Trust [1978] FCTD

Interpretation Bulletin IT-447 - Residence of a Trust or Estate
FCIT, p. 111-112

Trust: 3-party arrangement: settlor, trustee, and beneficiary. One person may operate > one role (not advisable for tax purposes). Settlor has ppty. Legal: title. Beneficial or equitable: real value. Settlor conveys legal title to trustee and confer beneficial ownership on beneficiary. Merely a relationship; not a legal entity.

104(1): Trust is to be read as reference to trustee, but only him in his capacity of trustee. Means income received as trustee. Notionally trust treated as entity for tax purposes (taxable as a separate person), even though not a separate legal entity in private law. Thus, it files a return and pays tax as a separate person. **104(2):** Trust deemed to be an ind, not a corp.

250(6.1): Deals with residence of inter vivos trusts – on exam.

No specific rules in ITA for determining residence of a trust (just contemplates that trust may be resident in Canada). Residence of a trust is a question of fact to be determined to the circumstances in each case. Normally trust resident at residence of trustee (use normal residency tests). IT 447: Prof: Might not be in accordance with law. 2 or more trustees with a division of responsibilities; if exercise > 50% of control, residence there. If not clear who has mgmt and control of trust, CRA will look at other factors: (1) Location where legal rights wrt trust assets are enforceable; (2) Location of trust assets. CRA: Normally don't look at residence of beneficiaries, but will if they really control. If corp'n, use normal residency rules; if branch, trust may be residence where branch office located even though corp'n itself resident outside that jurisdiction. *May be determined a trust is resident in Canada notwithstanding another country may consider the trust to be resident in that country. Will look at other factors if motivated by tax avoidance. *Class:

Normally beneficiary residence is not relevant, except if beneficiaries in actual control of ppty. Couple old cases say beneficiary residence is not relevant – **Holden**.

Thibodeau Family Trust [1978] FCTD

F: Trust with 3 trustees (2 resident in Bermuda, 1 resident in Canada - T). T probably connected to beneficiary (much connectedness and NAL). CRA: mad and want it Cdn resident. T likely much say in trust. Under trust law, if deed silent, need unanimous agreement between trustees to make decision. Can override default; here, majority decision (don't need T). 2 trustees rejected some of T's recommendations. If needed unanimous consent, CRA likely argue veto (would likely tip scale). [AB: lowest tax rate in Canada; ensure trust resident in AB so need AB trustee but more dangerous than director bc must look after beneficiaries, their needs and circumstances. Trust company? All head offices in TO or Montreal – need trust of CWB]. CRA not arguing trust not resident in Bermuda, but argue trust can be resident in > one jurisdiction. Individual and corporation (**Swedish Railway**) can both be resident in > country. ***Ask DS what if trustee is resident in > on country. What are the arguments of dual resident of trust? ME: Argument it is a pure question of fact and the Ct should look at all the circumstances.**

D: No, trusts cannot have dual residences bc a trustee cannot delegate his authority to another trustee (trustee cannot adopt a policy of masterly inactivity): **Underhill on Trusts**. Even if need majority, still only one location where decisions of trustee made. *Here, majority decision of trustees (may be different if not unanimous). ME: Also, res of trust in Bermuda, some beneficiaries for whole or part of yr in US, and Trust never carried on business in Canada.

Caution: old case and no cases decided since (only FCTD). Some criticized reasoning so maybe not 100% solid ground trust cannot have dual residence. Be cautious (preferred). Thus, to ensure trust resident in Cayman Islands, at least a majority of trustees reside there if not all of thing. IT-447 talks about trust ppty. Want bank account there, to extent possible, the trust ppty. Safety box with all share certificates.

If want Trust resident in Canada? DS: Don't use trustees who are resident in both places. Use trust company resident in jurisdiction to be trustee. Use reputable company bc much authority and trust in trustees. Never use a trustee with a home here in Canada.

Offshore trusts: **A protector**. Someone appointed by settlor to monitor trustee to ensure trustee acting appropriately. VK: Protector may or may not authority to remove or appoint trustees, may have authority to approve distributions to beneficiaries or at least distributions over a certain threshold amount, or approve expenditures over a certain amount. Don't want protector to necessarily be trustee – don't want them named a trustee and not control the trust. Maybe want protector to have a veto. VK: Risk that you look to protector for residence if has an unrestricted power to appoint and remove directors. Normally protector from where settlor located bc you trust him.

Inter-provincial planning: BC lottery winners wanted protector (rare for domestic). Objective to be taxed in AB. DS: Ensure trust resident in AB and not resident in BC. Want BC financial advisor as protector; thus, they severely limited his authority. Provision to reach fee agreement with guy in Calgary. If settlor and trustee cannot agree on fee, protector can do something. Settlor can appoint a new trustee (dies or moves from AB). Settlor can appoint or protector if settlor fails to do so. Said if financial well being of trust jeopardized, then protector can appoint additional trustees (can't remove AB trustee but now can outvote original trustee).

Tie breaker rule for trusts. Article IV, para. 4: if trust resident of both states, then two states by mutual agreement through competent authorities will try to determine where trust resident. DS: Fact Treaty contemplates trust can be resident in > one state may have implication. But could mean Canada my view trust resident in Canada and US view Trust resident in US. Doesn't necessarily mean Canada view trust as resident in both countries.

D. CHANGING RESIDENCE

ITA, s. 111(9), 114, 128.1(1)(a)-(c), 4(a)-(d)

Oceanspan Carriers [1987] FCA

FCIT, p. 104-105

If don't like Canada tax, simple tax plan is leave Canada and lose your Cdn tax status. Problem: often still have ties to Canada. Assume actually able to relinquish Cdn resident; tax consequences. Also issue when come to Canada.

114: Individual resident in Canada for only part of the year. 114 applies ONLY to inds not corp. Trust? 104(1) or (2) says trust is deemed to be an ind. So yes 114 applies to trusts [some ITA sections say "individuals other than trusts" so if say ind, must include trust]. If ind resident in Canada for part yr and NR for other part, when taxing ind, can ignore any income outside of Canada when ind. NR.

Example: A works for IBM and lives in NY. On Sept 1, transferred to TO for long term assignment (3 to 5 years). Huge \$ in NY for 8 months. Becomes a resident of Canada on Sept. 1 and resident in Canada for that part of year and thereafter. 114: Canada does not tax for first 8 months: only tax salary earned in Canada. In Canada, personal tax credits designed for whole year. Person must pay tax for 4 months, but another section says must prorate credit (1/3).

114: Where become a resident part way through yr, prorate everything. Not apply to corps (e.g. Oceanspan). Does not apply to sojourners. 114: only apply if resident for one part yr and NR other part. Sojourner sucks bc no prorating (don't get caught by it).

*Advantage to establish Cdn residence than be deemed a "sojourner" bc deemed Cdn resident for entire yr and taxable on worldwide income.

128.1: Changes in Residence: (1): Immigration: Where TP becomes resident of Canada (NR coming here) several things happen. **(a):** If NR corp or trust, taxation year will end

immediately before acquiring Cdn resident and new taxation year commences. Tf, ignore anything that happened before acquiring Cdn residence. 114 does same for inds. **(b)** TP deemed to have disposed of most of ppty immediately before acquisition of residence (won't get into exceptions – mostly ppty located in Canada). **(c)**: Deemed to immediately reacquire cost equal to FMV. Why? Don't tax gains or allow losses before became Cdn resident. *Nothing triggers tax immediately when come into Canada.

(4): Emigration: When taxpayer ceases to be residence in Canada: **(a)**: Deemed year-end and new taxation yr starts thereafter. Ends Cdn taxation. **(b)**: Deemed disposition. Exceptions narrower than other rule. Can trigger CGs, aka “departure tax” (but not a separate tax). **(c)**: Deemed to reacquire ppty (versus acquire in (1)). **(d)**: Elective disposition for individual: If file election, deemed to have disposed of some or all of those properties that would otherwise not be caught (e.g. real estate). *Use losses.

Oceanspan Carriers [1987] FCA

F: O Ltd. in Bermuda. Then became resident of Canada bc CMC changed (appointed Cdn directors) bc had losses and had profitable Cdn businesses.

D: Could not carry forward losses into Canada. “Taxpayer” is any person whether or not liable to pay tax. D: Never liable to pay tax. How does judge get around this?

Reasons: “taxpayer” def'n in context of whole scheme of Act shows it refers to resident inds or corps “who may be liable to pay tax at some time”, whether or not they are, at any given time, liable. A NR without income from Cdn sources can never be liable to pay tax under Act on its foreign income. Thus, not in def'n of “taxpayer”. Thus, any losses by NR corporation via business activities outside Canada are irrelevant under ITA. Can't see them being relevant and utilized under 111(1)(a) after NR corp becomes Cdn resident any greater than profitable NR become taxed after it became resident.

Reasons: Until the corp becomes a TP it does not have a “taxation year” as per s. 249(1)(a) so 111(1)(a) doesn't apply. ME: Ct says both Cdn residents and NR doing business in Canada are TPs regardless of whether liable to pay tax or not.

DS: Ct reading much into this. Criticize Basically saying must be resident to be a taxpayer, or must be resident to “may be liable”. Taxation yr? Ct said not until you're a TP bc 249(1): “for purposes of this Act”. Judge read a lot into this. If not subject to ITA, you have no purpose of ITA. Criticize? NR “could” become liable to pay tax in Canada (if you accept his TP argument). If can become liable, maybe need to know what your prior taxation year is. Counter-argument: From a policy point of view, don't want to allow losses from prior yrs. If O Ltd. profitable, not liable to Cdn tax if profits earned there.

O Ltd. tried to deduct loss for whole year. CRA: only allow loss after June 15. Ct allowed them to be deducted in full. Why? Liable for worldwide income for entire year so would have been liable for any income so in fairness should be able to deduct. Also, no 114

thing. **Provision in 128.1 did not exist then. Now no losses that straddle the date.** What about judge's reference to fairness and commonsense? Not normally relevant in tax law. **Annotation:** Change in law prompted by this case. 111(9) amendment: basically says for any TP in yr in which change residence status, losses from part of yr when TP was NR cannot be carried forward to another part of yr when resident. Tf, CRA successful in parliament. Now, bc of deemed YE for corps and trusts and 111(9), no way to get deductions. Even **Merali** (allowed losses forward where made election wrt rental ppty) may be overruled by 111(9). See IT-262R2: Losses of NRs and part-year residents, which supports this viewpoint.

V. ACTIVE INCOME EARNED IN CANADA BY NRs

FCIT, p. 1331-1333.

Not active business; here mean income not passive. "Active" taxed under Part I and "passive" under Part XXIII. Active broken down to employment, business, and disposition of taxable Cdn ppty. Branch tax later.

A. EMPLOYMENT IN CANADA

ITA, s. 2(3)(a), 115(1)(a)(i), 153(1)(a)

ITR, s. 102

Can-US Treaty, Articles XV, XVI

Hale [1992] FCA

Austin [2004] TCC

FCIT, p. 114, 1333-1341

2(3)(a): NR taxable income earned in Canada subject to tax. Assume NR employed in Canada. 2 situations: (1) Commuter lives in Detroit (border); or (2) Only in Canada occasionally or once in a lifetime, but if person working here, could be taxed on "taxable income earned in Canada".

115(1): "NR's taxable income earned in Canada": Amt calculated via 115(1) rules.

(a)(i): Assume NR no income other than from duties of office or employment performed by NR in Canada (VK: Cdn source income). Our focus is people not resident in Canada at anytime of yr (NR throughout yr). Key: Must perform employment duties in Canada. Where perform? VK: Question of fact. Must calculate income according to normal Part I rules.

Article XIV: Dependent Personal Services (EEs). Para. 1: Emplty income derived by resident of one country will be taxable only in that country, unless the emplyt is exercised in other country. Exercising likely means same as performing in s. 115. Allocation issue of how determine if income derived from one country or the other. E.g. US resident comes in 5 days a week and works for no one else. Para. 1 says Canada can tax all income. **Para. 2:** Main rule: emplyt income only taxed in residence. Exception if exercised in other country. **Exception: (a)** Income does not exceed \$10K in a particular

calendar year, measured in currency of country NR is performing employment services (Cdn advantage – can go to US and earn \$10K US). E.g. Microsoft EE comes to Canada to fix problem (won't earn \$10K so qualify for exemption); **(b)** EE present (assume US resident EE) in Canada (source country) for period(s) not exceeding 183 days in a yr. Need not be consecutive. Then person not subject to tax in Canada provided remuneration or salary is not borne by an ER resident in Canada or by a PE or fixed based that ER has in Canada. VK: Number of days here includes any days that the EE is physically present in the source country: includes part days. Maybe not holidays if the TP can show they are clearly not related to employment. Illness in middle of stay counts, illness at end of stay does not. VK: Exemption from tax by source country only applies if ER who pays the remuneration is not resident of country where employt exercised – tf, coming to Canada and working for Cdn sub, not exempted.

Explanation: ER resident in Canada with operations on both sides of border. EE travelling salesperson. Come to Canada for training and a couple clients. As long as not 183 days, meets test. **“Borne by”:** Technical Explanation under para. 1: “means allowable as a deduction in computing income.” Means deductible. DS: Of course ER will deduct, and tf, this particular person won't qualify. Interesting: exemption lost bc something ER not EE did.

VK example: If Cdn resident ind. is employed at a Cdn PE of a US company goes and performs services in the US, that income is not exempt to US tax if it exceeds \$10K U.S. since the US company is entitled to deduct such wages in computing its taxable income.

Example: NR ER headquartered in Europe. Office in Calgary with people working there. People from Europe go there regularly. If not here for 183 days, meet test. But bc engineering firm PE here, are subject to tax in Canada so will want to deduct salaries.

Example: Assume eligible for Treaty exemption (< 183 days and ER no PE in Canada or < \$10K). End? From EE's view, no! **153(1)(a):** every person who pays salary, wages, or other remuneration shall deduct or withhold and remit from payment amount determined by prescribed rules (source deductions). **Regulation 102(1)(d) sets amount.** Clear NRs subject to these rules. Means NR coming here for few days and ER outside Canada – ER should withhold source deductions and send to CRA. Rule is probably only respected when breach. CRA now cracking down; if chance to audit US company operations in Canada, will look at whether they withheld source deductions.

Hale [1992] FCA

F: H had \$125K stock option benefit. A Ltd. withheld \$35K of source deductions and sent to CRA. I: Is it taxable while NR of Canada (was in UK)? D: H lost. CRA was correct in stating \$35K withheld was tax owed via 2(3) and 115(a)(i)

R: H claimed Treaty exemption in Canada-UK Treaty. Like US: if employment not exercised in Canada, not subject to tax in Canada. Argued exercised option while in UK. CRA: 7(4) where person would otherwise be caught by (1) ceases to be EE – presume

employment still existed. Said employment presumed existed in 1984, so when exercised option must have exercised in Canada. ME: To be taxable, must be employed in Canada at the time of the benefit.

DS: Income not taxable in UK (tf, double taxation is not an issue). 7(4) presumes person still employed and employment still in existence. DS: But says no where that employment is exercised in Canada. In 1984, H a NR. If argue for CRA, say Treaty doesn't talk about when employment exercised. Is past exercise of past employment sufficient for afterward? Ct looked issue but didn't explore it thoroughly. Some discussion whether verbs in Treaty are past, present, or both. We don't spend time on that. ***VK: The case of **Tedmon** [1991] TCC is inconsistent with Hale – in this case the Ct appeared to impose Cdn tax when option was exercised in Canada regarding employment in US (have not read case but VK cases this). CRA has not stated how it stands on these inconsistent principles.

Article XVI: Artistes, Entertainers, and Athletes: E.g. US resident Chelios plays in Canada? For 6 games, makes over \$20K. **Para. 1:** Basically says Canada has right to tax him for his activities in Canada. **Exemption:** \$15K of gross receipts.

*Interestingly, CRA takes position 16 does not override 15. Suppose athlete earns \$14K: CRA says he qualifies for exemption under Article XVI, but still subject to tax under Article XV assuming he doesn't meet other exemption req'ts. DS: Not litigated. Maybe canon of construction that more specific overrides general.

Austin [2004] TCC

F: NR played 3 or 4 of 18 games in US and was paid per game. Clearly made more than \$15K and teams clearly deducting his salary (tf, 115 applies). Tf, did not qualify for Treaty Exemption. A only paid if played game. ME: What CRA said: spent 6 days of 365 so that income is attributable to US.

I: How allocate income that is taxable in Canada and income distributable to activities outside Canada? A used per game basis; Minister on per day basis.

D: Ct accepted Austin's theory: a paid per game and only paid if played.

DS: Criticisms of both approaches. CRA overboard in increasing Cdn allocation bc didn't excluded practice days in denominator and only allowed him 2 days for games in US. At trial, obvious at least 3 days. A's approach not perfect bc ignored training camp in Canada and practice days in between games.

B. CARRYING ON BUSINESS IN CANADA

1. General

ITA, s. 2(3)(b), 115(1)(a)(ii), 253, 255

Sudden Valley [1976] FCA
FCIT, p. 114, 1342-1344

2(3)(b): If NR carries on business in Canada, business income will be subject to tax under Division D (includes s. 105). **115(1)(a)(ii):** focus on income from business carried on by NR in Canada. **248(1): “Business”:** Includes a profession, calling trade, manufacture or any undertaking of any kind whatever and includes an adventure or concern in the nature of trade: single isolated transaction with characteristics of business but lacks continuity that a carried on business has.

Tara Exploration: I: Whether NR who has adventure in nature of trade was carrying on business in Canada. D: No. Ct wasn't sure if it was on solid ground. Thus, don't rely on case; just use if caught and reassessed.

Assume business. Where is business carried on (in or outside Canada)? Old cases: **Granger v. Goth:** Carry on business where contracts made, that is where offer is accepted. **Firestone:** Where situs of contract not reliable, place of operations.

253: Extended meaning of “carrying on business” in Canada: Expands situation where NR might be carrying on business in Canada. (a): growing, mining in Canada; even if export goods and contract for sale in other country, still deemed to carry on business in Canada. (b): Simply solicit orders or offer anything for sale in Canada, wherever contract completed. (c): Dispose of ppty with certain Cdn connection, deemed carrying on business in Canada.

255: Canada: seas, airspace, and coastal areas. If Canada has right to grant exploration rights, then in Canada. Hibernia in Canada.

Sudden Valley [1976] FCA

F: US company invited people to visit recreational lots in Greater Vancouver area with no mention of offering land for sale. Sale contracts done in US. SV had office in Vancouver, and spent \$1 million in ads there.

D: Taxpayer lost argument that he was carrying on business!

NR wanted to carry on business bc case straddles old and new ITA. Not making money so want to be taxed under Part I: rate 50%, but \$0 tax. Part 13 considers interest on sales of land investment income; with treaty reduction, tax rate of 15%. SV argued interest on unpaid purchase price a component in computing profit; even with interest, losing money.

Ct: Just inviting people to treat so does not constitute soliciting orders. Any difference between the two? Oxford def'n: solicit means to ask repeatedly or earnestly for or to seek or invite (business). If seeking or inviting business, should be solicitation. 253: must solicit orders. Order: a direction to a supplier to supply something. Ct used form over substance; couldn't tell from Ads anything was for sale. VK: Solicit means NR seeks

orders in Canada. But mere advertising a product for sale in Canada not enough bc not an “offer”.

VK: No single factor wrt whether NR carries on business in Canada: location of contract, where goods delivered, where payments made, location of its business assets, whether it uses agent or IC, location where it derives its profits, location of its bank accounts, listed telephone numbers, and addresses, substance of transactions, whether activities in Canada are integral or merely ancillary to its main business.

2. Commercial Enterprises (Business Profits)

Can-US Treaty, Articles V, VII

Fowler [1990] TCC

Toronto Blue Jays Baseball [2005] Ont. CA

FCIT, p. 1344-1353, 1357-1359

Article VII: Business Profits: Para. 1: Business profits of a US resident shall only be taxable in the US, unless that US resident carries on business in Canada through a PE in Canada. Only profits attributable to PE in Canada may be taxed in Canada. DS: Good for mail order business (no PE). \$5 handling fee plus GST for parcel from US – not income tax but try make up for it.

Article V: “PE”: Para. 1: Means a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on. Tf, mere physical presence is not enough. E.g. Renting a piece of land not enough if don’t use it you’re your business. **Para. 2:** PE shall include especially (VK says not deemed a PE – must still be permanence): place of mgmt, branch, office, factor, workshop, and a mine, oil or gas well, or any other place of extraction of natural resources. **Para. 3:** Building site or construction or installation project only if it lasts more than 12 months. **Para. 4:** Drilling rig or ship to explore or exploit natural resources only if use is for more than 3 months in any 12-month period. **Para. 8:** If NR with sub in Canada, sub in and of itself will not be a PE of NR parent. NR Parent may run business through Cdn sub – sub subject to tax in Canada but some comfort parent itself won’t be subject to tax on business in Canada simply by virtue of sub. Different if parent does some business in Canada. **Para. 5:** A person acting on behalf of a business (agent), shall be deemed to be a PE if the person has, and habitually exercises an authority to conclude contracts in the name of the resident. **Para. 6:** Not a PE if use facilities just for storage, display, delivery, advertising, etc (ME: likely website).

Fowler [1990] TCC

F: US resident individual lived in US but ran booth at Vancouver exhibition in summer selling knives (all else in US). Net profit in Canada of \$33 and next \$23, represented 10% of his income. Portable booth. Did for 15 yrs arguing not subject to tax in Canada. Conceded NR carrying on business in Canada, but said little stall not a PE. Cancellation clause could kick him out.

D: CRA won. Every yr for 15 yrs had an element of permanence. Pattern of permanence established. Not much analysis; said spot had same attributes of a branch.

Toronto Blue Jays Baseball [2005] Ont. CA (not read?)

F: Not tax case. Ont. health tax every ER must pay for EE. I: PE in Ont. or Que.? Team argued lockerroom was PE of Cdn team – need pass to get in. R: TJ: Teams won; when on road, offices in Ont. are PEs of team.

CA: No PE. Locker-room not like branches or management. Much more to running sports team than putting team in locker room; scouting, planning, advertise. Much of this happens at head office, and teams conceded head office in Ont. CRA conceded Blue Jays spring training in Florida PE. SCC: Dismissed leave to appeal.

Tax Plan: Would Fowler decision be different? If give weight to Blue Jays case, may be able to do more. CRA commented on Blue Jays case and don't think good law. CRA will continue to apply Fowler where quite easy to establish PE. Why wrong? Definitions of PE in every tax Treaty. Def'n of PE in ITA Regulations. That's for inter-provincial issues. In Blue Jays case, Ont. leg'n had PE definition. Def'ns essentially same bc mostly based on OECD. OECD commentary to interpret PE: 3 concepts of a PE: (1) Place of business; (2) Place of business had to be fixed; and (3) Business must be carried on through that fixed place. CRA: Ont. CA did not go through 3-part analysis. Also, Ont. CA relied on **Syntex** decision and CRA never like either. Also, Treaties generally indicate it's sufficient if NR carries on business wholly or partly through PE.

Yankees who play in Toronto? Ont. CA: would say Yankees no PE bc Blue Jays don't. Does CRA expect Yankees (the team, not inds) to pay tax on income they earn.

ME: OECD Commentary states that the place of business need not be actually fixed to the soil on which it stands. Immaterial if rent or own. VK: Travelling salesman in a hotel room may qualify as a PE. A place of business set up for short period may still constitute a PE when look at the nature of the activity.

VK: NR parent can operate business in Canada through a Cdn corp. The Cdn corp is taxable in Canada on its worldwide income [2(1)]. Several advantages:

- Sub is a separate legal entity, so parent limits its liabilities for the sub's debts
- Since sub a separate legal entity, it will generally report only its activities without disclosure of parent's operations
- Since separate entity, easier to account for its income and expenses and there are fewer expense allocation problems
- Subs with substantial (at least 50%) Cdn equity ownership may be eligible for SBD.
- Generally easier to conduct business reorganizations for corporations than reorganizations of other entities or relationship.

Disadvantages:

- Parent cannot utilize its losses for Cdn tax purposes
- Thin capitalization rules apply to subs that are minimally financed with NR equity capital
- Withholding tax of 25% (subject to Treaty reduction) applies to dividends from Cdn sub to NR parent corp
- Subject to Treaty exemptions, CGS that parent corp realizes on an arm's length sale of its shares of a Cdn corp are taxable in Canada.
- Sub may be resident in both Canada and its home country. Problems of double taxation, but treaties have tie-breaker rules
- Purchase and set-up of sup is generally easier than the purchase of an unincorporated business. (disadv?)

3. Independent Personal Services

Can-US Treaty, Article XIV
Dudney [2000] FCA

Article XIV: Independent Contractors: Only applies to individuals not corporations. If ind. resident of US has income from a business carried on in Canada through a fixed base regularly available to the person in Canada, then income will be subject to tax. Example: US lawyer visits TO client; stays in hotel and goes to client's office. No office in Canada, but is working. Taxed or exempted? Fixed base? Likely no if consider Dudney (ME: Actually that exact example given in Dudney). These facts much weaker than Dudney. *Interesting: although PE defined in Treaty, fixed base is not.

Dudney [2000] FCA

F: US resident but work in Canada in training EEs of company. CRA said "fixed base" and assessed under Article XIV.

D: Not a fixed base. Taxpayer did not have exclusive use of office, nor control over premises in which he worked, nor freedom to enter building whenever he chose. No letterhead or business card. Spent 300 days in Canada. No space for exclusive use (unlike Fowler?). ME: OECD says an identifiable location with a degree of permanence.

R: For D to run his business, more than just doing activities client was paying for; also billing, marketing etc (like Blue Jays), which is not at client location. No business cards or telephone directory. Found business not actually carried on there; only his contractual duties carried there but that's distinct from carrying on business.

Ratio: Interpreted fixed base to essentially mean the same as PE. Income Tax Technical News #22: CRA accepts Dudney in cases where "the taxpayer does not have sufficient physical control of space to be carrying on his or her business in a particular place."

DS: Fowler little square for 3 weeks and was PE. D has office, desk, and there for a year or so. Which better view? Control, but Fowler could be kicked off. Cases arguably go

both ways. Inconsistencies but tax authorities will try rationalize two cases. CRA won Fowler, but lost Dudney. Leave to SCC dismissed.

ME: **Sunbeam** SCC in domestic tax case. Dudney: Factors: actual use of premises, whether and by what legal right person exercised or could exercise control over the premises, and degree to which the premises were objectively identified with the person's business. Not an exhaustive list.

4. Entertainers and Athletes

Can-US Treaty, Article XVI

Sumner [2000] TCC

Article XVI: Para. 1: As above, apply to either athletes or ICs. **Para. 2:** Deals with “game playing”. Entertainers and athletes subject to tax if perform under their name. Thus, set up corp without PE in Canada with corp contracting for her services to be provided in Canada; corp earn all \$ in Canada. Tf, EE of corp from tax haven and avoid paying Cdn tax. Works, but for para. 2: If re-direct income to another person, income still taxed, even if other person has no connection to Canada. Real issue: whether that income is accruing not to entertainer athlete or to another person. But if any sort of arrangement where profits or bonuses (etc) can somehow find way back (directly or indirectly) to entertainer, Ct will view as having accrued to it.

Sumner [2000] TCC

F: UK resident TP, GS, performed concerts in Canada and was paid by ER, R. Inc (US – no PE in Canada).

R: TP an EE so Article XVI, para. 1 clearly makes TP subject to tax, but issue was how much taxable in Canada. One approach: # days in Canada and outside Canada (TP wanted – but suspect bc denominator includes days not on tour). Other: Total revenue from whole tour and gross revenue from Canada and did apportion. Reverse onus: gov't correct until prove wrong. **ME: Portion not taxed in the hands of the entertainer can be taxed in the hands of the person receiving the remuneration – is that right?**

D: TP could not show approach better than CRA so TP loses. TCC: Clearly indicates that paragraph 2 of the Canada-U.S. treaty does not envisage an either/or, or all or nothing situation. Rather it contemplates that a performer's income may be earned in part by the performer personally and in part by the company, and both may be taxed.

Argument: Para. 1 and 2 of Article XVI are mutually exclusive. If actual entertainer taxable under para. 1, then R Inc. cannot be taxed under para. Ct: No, both paragraphs operate in tandem.

Argument: Some income taxed in EE's hands (modest), but exclude income from corp.

DS: TP tax advisors have structure bc R Inc. not his ER (corp in Netherlands not owned by TP). Employed TP and made services available to R and R paid TP, but not as salary. Likely for did for US and UK, not Canada.

5. Regulation 105 Withholding

ITA, s. 153(1)(g)

ITR, s. 105

Ogden Palladium [2001] TCC; aff'd [2003] FCA

*Although come to Canada and may not have to pay tax, not home free (might be tripped up by a withholding tax).

153(1)(g): Fees, commissions or other amounts for services. If so, must look at prescribed rule: **105 of regulations.**

105(1) of ITA regulation: Non-Residents: Rule does not apply to Cdn resident. Every person paying a NR person a fee, commission or other amount [same as 153(1)(g)] wrt services rendered in Canada, of any nature whatever, shall deduct or withhold 15% of such payment. Reason: COL general rule: Ct of one country cannot collect taxes in another country (tf, Reg 105 pre-pays tax).

Example: US lawyer with no PE or fixed place of business in Canada. Treaty exempt so sends client a bill. NR? Yes. Render services in Canada? Yes. Do fees relate to those services? Yes. Thus, client must withhold 15% of invoice and give to CRA. Withholding a mere instalment, not actual tax liability. Can file Cdn income tax return and claim refund (bc Treaty exempt), but must wait over 4 months (interest free loan to gov't).

Treaty-based waiver of withholding is available in certain circumstances [IC 75-6R, para. 10-16] (need documents that resident in country Canada has Treaty with to ensure resident at CL and Treaty). CRA will want most recent tax returns (see if liable to pay tax) and any notices of assessments. Can then show waiver to client. Can also get waiver if show profit margin will be less than 15% (need expense calculations). CRA will want contract, projected number, pro forma statements bc predicting future (effort may be worth it).

*Payer need not be Cdn resident (says "anyone" who pays \$ to NR must withhold). Payer may be insulated if NR outside Canada but problem if assets in Canada that CRA can go after.

*Payer need not be recipient of services (e.g. receiver ends up making payment to NR, but receiver still a person and subject to 105).

*Nr to whom payment is made need not be person who provided the services. In fact, services may be provided by Cdn resident. Example: Client headquartered in Italy with contract in AB. Entity does some work in Italy, some in AB office, and sub-contract some to other entities in Europe and Canada. If entity invoices everything, even work done in Canada, whole payment becomes subject to Reg 105 withholding. Have PE in AB. Will invoice out of PE for work done in Canada. Reg 105 only applies to work done

in Canada. But have separate invoice for Italy for work done outside Canada. Problem: All sub-contracting work done in Canada subject to Reg 105 for payments made to Italy.

227(8.4): If Cdn payer fails to remit withholding, liable for whole amt that should have been withheld (15%!).

227(9.1): Penalty for failure to remit only applies to amounts in excess of \$500.

227(8): If fail to withhold, 10% penalty on amounts that should have been withheld.

227(8.3): Interest on amount that should have been withheld payable at prescribed rate (more or less market rate plus 4%).

227(8.1): NR is jointly and severally liable for interest in (8.3) (still hard to enforce). But not penalty. Note: Under CL, if make payment, have right to contribution (unsure if applies). Regardless, won't get penalties.

227.1(1): If corporation fails to withhold, directors also have personal liability.

75-6R2 on Reg 105: CRA: If you as Cdn payer not sure payment subject to Reg 105, err on side of withholding. NR counsel may be upset.

Ogden Palladium [2001] TCC; aff'd [2003] FCA

F: TPs were owners of entertainment facilities. Executed license agreement with US promoter for figure skating shows. TP was to provide venue, staff, collect ticket money. Promoter sought and was denied exemption from withholding req'ts. TP paid money directly to promoter and did not withhold. CRA assessed via 153(1)(g) and penalties under 227(8). D: TP lost.

Weird: Would think TP providing services to NR (TP argued). CRA argued service provided to public or by figure skater. Could NR (corporate entity) benefit from show? Contract between TP and NR, but audience bought tickets from TP. Evidence figure skater may have provided services to ticket holders.

D: Reg 105 applies: "every person paying fee to NR "in respect of services" is required to withhold amounts in respect of income tax". Promoter's activities amounted to "services". Payment went from P to M (NR). Does not matter who provided services as long as payment in respect of services in Canada (or who receives services). Also, irrelevant if provider of services was resident or not. Services must simply have occurred in Canada and payment went to NR. Found service may or may not have come from M (may be from skater); either way, found 105 found apply. What is definition of "service"? Dictionary: Assistance or benefit provided. Process by which result achieved. **ME:** Words "in respect of" given a liberal interpretation. Also argument producer provided services to public. Also, but for producer, show would not have occurred.

FCA confirmed TCC decision.

Fair? P provided services to M. Poor city. Fact: in previous yr, same company put on similar tour and applied for waiver and got it. In second yr, waiver denied. DS questions

whether it was really a payment for services. Is Elvis an EE of M? M, ever time he pays salary to Elvis, should withhold but maybe M doesn't have PE in Canada. Might be a right result, but definitely unfair.

*****So even if Treaty exempt for sure, still think of Reg 105. Is there a due diligence defence as stated in Ogden (although they did not meet it)? If so, where is the authority? Pillar Oilfield: Due diligence defence – only to the penalties.**

6. Branch Tax

ITA, s. 219(1)

Can-US Treaty, Article X, ¶ 6

Context: USCo (big multinational) wants to come into Canada. Sets up wholly owned sub (CanCo). CanCo earns \$100K in income. \$60K after-tax. USCo needs money so causes CanCo to declare \$60K dividend. When Cdn resident pays dividend to NR, attracts Part XIII tax (25%, pay be reduced to 15% by Treaty). Tf, \$9K tax so \$51K to USCo. Tax advisor: Why have separate company in Canada; just go there themselves. USCo operates via branch; not a separate entity (registers extra-prov'ly in AB CBA). Tax payable under 2(3) so \$40K (not CCPC). But not separate entity, so need not pay dividend so just transfer funds. Eliminated \$9K tax. Gov't mad; NRs active in Cdn economy and not \$9K withholding tax. Tf, introduce branch tax on NR's Cdn branch under Part XIV of ITA. Merely need NR corp carrying on business in Canada; need not have PE. ONLY applies to NR corporations, not individuals or trusts. Won't do major calculations of tax.

219(1): Additional Branch Tax on NR Corporations: NR corporation must pay a branch tax of 25% (same as Part XIII withholding tax) on (a) Corporation's taxable income earned in Canada. Same phrase in 2(3) and defined in a sense in s. 115. Earned in Canada and thus subject to tax. Add and then deduct some things (deduct taxes paid under other ITA provisions). Why? Trying to replicate results of sub paying dividend. Subs can only pay tax under their after-tax profits.

219(1)(j): Amt prescribed to be an allowance in respect of an investment in property in Canada. Example: Cdn sub \$60 after-tax income uses \$20K to expand its plant. \$40K left for dividend. Now, our tax only 15% of \$40K. Tf, no withholding tax on amount reinvested in Canada. Allowance keeps it same. Want neutral decision to operate as branch or sub [**Reg 808** rules wrt calculating allowance].

219.1: Corporate Emigration: Heard in 128.1(4). When corp continues out of Canada, tax consequences including deemed disposition of all of its taxable Cdn ppty. **219.1:** if corp ceases to be Cdn resident, must pay tax of 25% on FMV of all its ppty less certain amounts (PUC of shares and debts it owes). Tf, in addition to 128.1, form of exit branch tax payable when corporation ceases to be resident in Canada.

219.2 and 219.3: If Canada has Treaty with country and in Treaty, withholding tax rate on dividends is reduced to particular rate (e.g. 15%), then branch tax will be similarly reduced. Mirror objective again.

Article X: Dividends: Para. 1: Dividends paid by a company to a resident of other Contracting State may be taxed in that other state. **Para. 2:** (a) 5% tax rate where SH is corp owing 10% or more of voting stock of company paying dividends. (b) 15% of gross amount of all other dividends.

Para. 6: Branch tax is 5% (consistent with para. 2). Tf, ITA and Treaty provide double-coverage. **6(d): \$500K exemption.** When NR operating branch in Canada, can earn \$500K in Canada and not pay any branch tax (still Part I tax). Tf, must do calculation to determine if NR client should operate as branch or sub (precise tax rates, surtaxes, etc). Also, would love losses from branch in Canada. Thus, might use branch, take losses, earn up to \$500K, and then re-valuate – incorporate sub and do s. 85 rollover and transfer branch assets into Cdn sub.

C. DISPOSITION OF TAXABLE CANADIAN PROPERTY

ITA, s. 2(3)(c), 115(1)(a)(iii) & (b), 116

Can-US Treaty, Article XIII

Merlis Investments [2001] FCTD

FCIT, p. 114, 1374-1375

2(3)(c): Disposition of TCP. If dispose of TCP, must pay tax via (d) – contains 115 and 116 (looked at before).

115(1)(a)(iii) states CGs from (1)(b) subject to tax. **115(1)(b):** NR subject to tax on taxable gains from disposition of TCPs (ME: other than Treaty-protected properties). Thus, really under Part I.

VK: Generally calculate NR CGs and losses according to usual rules applicable to resident TPs (Division B, subdivision c). However, a NR may not: deduct a reserve in calculating CGs (40(2)(a)(i)), rollover capital ppty to a spouse (70(6)), take full advantage of the principle residence exemption (40(2)(b)). However, they may deduct ACLs against TCGs.

248(1): “TCP”: (a) Real property situated in Canada (land). (d) share of capital stock of Cdn resident corp not listed on a prescribed stock exchange (private Cdn corp). (f) shares listed on public stock exchange and TP or NAL parties, or combo thereof, hold 25% or more of issued shares of any class. *If NR subject to tax, must file Cdn tax return.

116: Section 116: Admin, not substantive, procedures must be dealt with when a **non-resident** (assume no chance, just wholly owned sub Canco) [**at date of sale – close date**] **vendor sells taxable Cdn property.** If not, penalties or jail (s. 238 – any ct but most QB). DS: Show transaction treaty exempt or no gain (rollover, loss transaction). Or

acknowledge gain subject to tax. Estimate and pay tax. Or put up security (bank letter as guarantor bc tax bill large). CRA will look for Treaty exemption, gain/loss on sale, or security.

1. Optional/Proactive method, s. 116(1) and (2).

a) Notice Requirement

Any time **in advance** of the sale [close date – money exchange], non-res can send notice to Minister setting out 5 things:

- **1.** Name and address of purchaser and vendor.
- **2.** Description of ppty sufficient to identify it. Eg legal description of land.
- **3.** Estimated amount of proceeds of disposition. DS: CRA asks for copy of sales agreement. Crap: was refused certificate until signed copy of agreement. Problem bc often sign and close on same day.
- **4.** ACB of property to vendor [purchase price and costs to place in usable state] DS: Must send documents to prove ACB, contract of sale for proceeds or rollover agreement.
- **5.** Non-resident vendor's signature or his or her duly authorized representative [client required to sign a special form]
- No mandated notice form but CRA created T2062: Request by non-resident of Canada.
- Gift not sell: **Must still comply with s. 116** [notice/cash]. S. 69: Deemed sale for non-arm's length transactions at FMV (a presumption) and acquire at FMV. Gift or sell at FMV or risk possible double taxation.

AND b) Money Requirement

- Cheque to Receiver General of **25%** of "net gain from sale" [116(1)(ii)].
- **Net gain** = Proceeds less ACB **but not selling costs**
- **Tax rate = 50%**. Bc 25% of CG not TCG.
- Non-resident **should file Cdn tax return** bc overpayment and not high on gov't list. Why?
- **1.** Assuming 50% when actual rate is less. If 2(3), marginal tax brackets and personal tax credits available [tf, likely 30% not 50%]. Highest MTR in AB is 39% but non-res not prov'l but surtax.
- **2.** Can deduct all allowable expenses [eg selling]

If do the two steps,

- CRA issue non-resident vendor a **clearance certificate (T2064)**. Deal go ahead without CRA interference subject to caveat **actual proceeds equal or less than estimated proceeds** in notice [and other things correct]. If net gain large, CRA may allow account available to gov't. If don't know exact proceeds, don't guess high bc could wait 15 months to get back excess.

2. Mandatory Method, s. 116(3) and (4)

- Follow mandatory method if: (a) did not use proactive method (b) terms changed from ACB or proceeds
- Must be done **within 10 days of the disposition** (sale closed) or subject to minimum \$1,000 penalty to max of \$25,000 OR jail time up to a year (rare if 1st offence). Form 2062 says min of \$25/day with min \$100 but go with ITA.
- If did proactive but more proceeds, just send difference

Same procedure. 5 notice req'ts (**except put actual price**) plus 25% of net gain.

- 1. Must comply even if no gain or sold at lost.
- 2. Must comply even if treaty prevents Canada from ultimately taxing non-res.
- 3. If do this, get a clearance certificate.
- ****Doesn't matter if dealing with a resident or a non-resident purchaser**

Tax Implications/Risks to Purchaser

ITA 116(5): Purchaser [can be NR] of taxable Cdn property under s. 116 from NR, unless one of 2 conditions (below) satisfied, must pay receiver general within 30 days after month deal closes, **25% of purchase price [FMV]!!**. Eg. If transaction in Oct, then Nov. 30th. DS: Thus, try do deal on 1st of each month so gives you 2 months. But economics of deal may dictate differently: e.g. want transaction in certain fiscal yr or particular quarter (public companies).

Vendor: \$200K proceeds less \$150 ACB = \$50K net gain, tax 25%, taxes payable \$12.5K. (25% of net gain)

Purchaser: \$200K x 25% = \$50K taxes payable. Rationale: easier to go after purchaser since ppty in Canada and overestimate to be safe.

1. Purchaser had clearance certificate, with all info matched [notably proceeds].
2. After **reasonable inquiry**, no reason to believe vendor NR.
 - Purchaser could **withhold 25% of purchase price** and remit to Receiver General (let vendor get money back)
 - Purchaser demand proactive method to get clearance certificate in advance (ie \$ not leaving until certificate). CRA must receive it within 10 [working?] days.
 - **Vendor declaration** that resident **not enough**
 - Purchaser could sue vendor for tax burden: contract, but jurisdiction, costs, etc.
 - Contract: vendor provide Clearance Certificate; if not, no sale or parties agree purchaser remit 25% to Receiver General.

DS: Send application for Clearance Certificate ASAP and hopefully CRA not take too long. If no Certificate, purchaser pays 75% to vendor and 25% paid to trust (typically purchaser's lawyer). Lawyer under trust obligation that as soon as vendor gets clearance certificate lawyer must send to vendor. What if no certificate by 30 day deadline? Clause that if clearance certificate not on time, lawyer sends to CRA. Wrinkle: CRA may tell vendor they will send letter to purchaser's lawyer (do not remit letter); know you're holding money; don't send in until we tell you otherwise. Thus, can continue to hold money. Then eventually get clearance certificate, or, if not, release to CRA. But sometimes "no remit" letter; but they want security (e.g. the \$25K).

Merlis Investments [2001] FCTD

F: Barbados corp sold Cdn corp shares. Claimed CG exempt under Treaty so should get money back that was remitted to CRA [neat – ind. moved to Barbados]. D: 158 not relevant bc CRA already had money. Declined to grant mandamus.

DS: More useful for facts. GAAR: arranged Cdn corp shares for sale to NR and claimed Treaty exemption. Mr. K was Barbados resident. Sought mandamus to compel Minister to pay refund (not clearance certificate bc money already there).

*Delay by CRA – can't get mandamus.

Article XIII:

Para. 1: “Alienation” (likely same meaning as disposition). Deals with dispositions of real ppty in other contracting state. Country where ppty situated may tax gain on disposition.

Para. 2: If NR (say US resident) has PE or fixed base in Canada that relates to business, and any personal ppty part of that fixed base or PE, any gain on that may be taxed in Canada.

Para. 3: Defines **real ppty**. **(b)(ii):** Refers to Cdn resident company share, value of whose shares derived principally (>50%) from real ppty. E.g. CanCo land in Canada. If land FMV > 50% of FMV of CanCo, shares deemed real ppty. So if USCo sells shares, same as if sold land so gain taxed as per para. 1.

Para. 4: Gains from alienation of ppty other than 1, 2, 3 taxable only in country where vender resident. Helpful in corporate reorganizations. Change facts: assume FMV of land < 50% of FMV of CanCo. Now, not real ppty. USCo can sell and **whole is Treaty exempt** (often bc modern economy land not much value) shares not deemed to be real ppty. Canada gets no part of gain. Rationale: Canada jealous of land.

Again: Treaty exemption does not negate 116 (but might be easier to get a Certificate).

VI. PASSIVE INCOME DERIVED FROM SOURCES IN CANADA BY NRs (was part 1, not part 13)

ITA, s. 212(1)(a)-(d), (2), (4), (13.1), (13.2), 214(1), 215(1) & (6), 216(1) & (4), 227(8)

Can-US Treaty, Articles X, XI, XII

Easter Law Trust [2005] TCC

Transocean Offshore [2005] FCA

FCIT, p. 143, 1377-1389

A. General

212(1): Every NR (not tax on Cdns but see later withholding taxes, but true TP is NR) person shall pay an income tax of 25% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit (pitfall), to the NR person as, on

account or in lieu of payment, or in satisfaction, of (not just direct payment – includes anything as substitute):

*Onerous when rules deem residents to be NR.

214(1): Tax payable under 212 is payable on amounts prescribed therein without any deduction from those amounts whatever. *I.e. on gross, not net.

212(1)(a): management fees or administrative fee or share. (b) interest. (d) rent, royalties. (2): Dividends.

Framework: 215(1): Withholding and remittance of tax: When pay or credit amount (or deemed) under which income tax is payable under Part 13, payer must withhold or deduct amount and send it to Receiver General on behalf of NR. *Doesn't say must be Cdn resident (only 212 says that); broad enough to catch any payer anywhere. Must submit remittance in prescribed form. *VK: Withheld at source of payment.

VK: Since NR may not have business assets in Canada, the Cdn tax authorities may not be able to enforce payment of tax. Thus, this is like a pre-paid tax.

215(3): Payments to an agent: NR may appoint agent, often in Canada. Cdn resident, if, pays interest, rent, or dividend to resident agent (not NR). Once agent gets \$, must withhold and remit.

215(5): Reducing Amount: Governor in Council may make regulations to reduce.

215(6): Liability for tax: If should have withheld tax and not done so, that person becomes liable to pay tax. Thus, CRA can go after Cdn resident.

227(8) and (8.3): Same as **Regulation 105:** Interest obligation and penalty.

B. Management Fees

212(1)(a): Management or administration fee or charge (aka, "management fee").

Exception in 212(4): Interpretation of management or administration fee or charge; Mgmt fee does not include an amount that relates to a service performed by NR if 2

conditions met: **(a):** (i) Service must be performed in ordinary course of business carried on by NR that includes provision of that service (e.g. US consulting firm with some clients in Canada- call mgmt fee); **and** (ii) NR and payer must deal at arm's length. E.g. Cdn really client of NR. VK: **Swiss Bank** comments on arm's length, as well as **IT-419**.

(b) Other exception: Specific expense incurred by NR person for performance of a service that was for the benefit of the payer to extent amount paid was reasonable. DS: Aka out of pocket expenses. Example: USCo and CanCo. CanCo pays USCo for head office services. Services by NR, but Q if its ordinary business. If overhead, not under (a). But if problem with CanCo computer system, and US person must fly to Canada and USCo bills CanCo for airline ticket, specific charge under (b). Purpose: Parent-sub relationship so interoffice overhead cannot be used to strip overhead from CanCo to USCo. 212(1)(a) takes disguised profits as intercorporate fees and tax them as mgmt fee.

Reg 805: Every NR person who carried on business in Canada is taxable under Part 13, except those amounts that:

(a) Key point: May be reasonably attributable to business carried on by NR in Canada through PE (if so, not under Part 13 taxation). PE defined in **400(2) of Regulation:** Similar to Treaty definition.

Example: If head office providing services through PE in Canada, any payment services not subject to Part 13 tax. Sub itself not a PE (under 400(2)). If want to rely on Reg 805, need PE other than sub. ***Ask if economic benefit; likely not worthwhile. If do in fact have PE in Canada, under **805(2)** can apply to CRA for waiver or exemption from a withholding tax.

Example: NY Bank wants to lend \$ to Cdns through US corp but set up physical branch in Canada. PE so when borrowers in Canada pay interest to City Bank, not necessarily subject to withholding tax (might though so see later). Must file tax return under Part I for that PE and calculate your income in usual manner on an annual basis.

Article VII: Business profits: US resident taxable in Canada in respect of business profits earned in Canada but only to extend PE in Canada and profits attributable in Canada. Broad enough to include mgmt fees. Tf, if head office in US and carrying on business in Canada by providing overhead services and no PE, have Treaty exemption so need not worry about **Reg 805 or Part 14**. Still need a waiver of withholding.

Peter Cundill & Assoc (not in syllabus)

F: PCA Ltd. (Cdn). PG owned 50% and other unrelated parties owned 50%. PG owns 100% of PCA Bermuda Ltd. PG controls PCA Bermuda but not PCA Ltd. PCA Bermuda provided PCA Ltd. services and PCA Ltd. paid a fee. CRA assessed PCA Ltd. for not withholding tax. If paid direct to PG in Canada, much tax. Tf, large fees to PCA Bermuda. CRA: 212(1)(a) fee so 25% withholding tax. TP argued not related so arm's length so get exception under (4). Tf, issue whether arm's length.

Corporate: If related, deemed NAL. If unrelated, question of fact if NAL (251(1)(c)).
TCC: PG directing mind for both corporations. TP lost.

FCA: CRA won bc finding of fact by TJ directing mind for both corps. DS: At one point, PG > 50%. Interesting bc OSC required 50%. E unrelated parties took active role. Directing mind: question of fact – may have clout from your skills. At 50%, can produce stalemate. Treaty provision? PCA Bermuda Ltd. did not have PE in Canada. **Trick** question: No treaty with Bermuda so could not rely on Treaty exemption. If PCA US Corp'n, likely get Treaty exemption but US taxes lots.

C. Interest

212(1)(b): Every NR must pay a 25% tax on the following amounts:

(b) Interest, “except”.

Things might encounter: NR bank loans \$ to Cdn resident who pays interest is subject to Part 13 tax. Also, company sells goods in Canada. If NR corp starts charging interest on

Cdn and Cdn pays, technically, should pay Part 13 tax. Or US resident accident in US and interest in trust. Should withhold!

1. (ii): “Gov’t guaranteed debt”; . If gov’t (fed, prov’l, or municipality) borrows \$ from NR lender, they themselves need not withhold tax on interest they pay to NR lender.
*Want access to foreign financial markets bc can negotiate lower rate.

(vii) “5 year corporate debt”: No withholding tax on Part 13 on interest paid or payable by Cdn resident corp (not ind, trust, partnership) to arm’s length person (tf, not parent or related corp) issued after 1975 (no prob). Under terms of debt obligation or any related contract (guarantees), borrower cannot be required to pay > 25% of principle within 5 years from date debt issuance – give yourself extra day even though IT bulletin says okay to put payable Oct 27/09 if Oct 27/04 [must be committed to Canada for 5 yrs].

*Clause saying repay 5% of principle per yr for 5 yrs = 25% okay.

*Borrower voluntary pre-payment clause okay.

4 exceptions to 5 year rule (okay to have compel):

(C) Default or failure (i.e. accelerated).

(D) Loan obligation or agreement becomes unlawful. E.g. Leg’n or Ct action.

(E) Loans with conversion privileges or rights, where lender can convert to shares or other equity instrument, so long as prescribed security cannot be repurchased in 5 years.

(F) Lender dies. Borrower must be a corporation but lender can be individual.

*If loan document, look at all provisions that deal with repayment.

GE Capital [2001] FCA

F: GE borrow money through 4 different 5 yr loans. Amended loan agreements (assignments – okay) and changed maturity date well beyond 5 yrs when \$ originally advance, but amended maturity dates were < 5 yrs after amendment. CRA: New loan obligation didn’t meet req’ts. TP: No novation and need novation to start 5 yr clock.

FCA: TP lost. Ratio: Need not have novation. If obligation and make substantial changes to its fundamental terms that materially alter terms of obligation, then creating a new obligation. Fundamental terms: [if was novation, definitely lose]

1. Identity of debtor. 2. Principle amount of obligation. 3. Interest rate. 4. Maturity date of obligation. Identify of lender not there bc often factor loans. Debtor IB bc credit worthiness. ***Be careful if making changes to 5 year loan. *SCC appeal dismissed.

DS: “issue or **obligation**”. Novation not necessarily the same as a change in obligation.

Found novation is a question of fact, so whether new obligation is also a question of fact.

Article XI: Para. 1: If pay interest out of Canada to US resident, US can tax (obvious).

Para. 2: Interest may also be taxed in country that it arises (e.g. Canada), but if US resident is beneficial owner of interest, taxed at 10% (huge reduction). Treaties may vary.

Example: CanCo needs to borrow \$ and don’t qualify for 5-yr loan (don’t care about rate if 5 yr bc exempt). No \$ in US but loan in Bermuda at 2 or 3% less. No Treaty with

Bermuda so 25% rate. Analysis: Take CanCo and set up a finance company in low rate treaty jurisdiction (US for that matter). Determine if must pay withholding tax of country where finance company located. E.g. Sweden withholding tax so no real benefit. But if separate corporation in Bermuda, that borrows \$ from Bermuda bank, and uses \$ to get shares of Swedish finance company and loans \$ to you in Canada. Can deduct interest here. Only withhold 10% of interest from Canada going to Sweden. Can get \$ to Bermuda by withholding tax. Unsure. Key: Learn criteria: E.g. Dividends without withholding tax, and hopefully no tax on foreign capital.

In Part 13, deeming rules can trip with bad results. 2 main ones:

212(13.1): Part I tax applies where payer or payee is partnership. Partner can be deemed a NR so, if partnership, be careful.

212(13.2): Where NR person whose business is carried on principally in Canada, and that NR paying interest to another NR, first NR shall deemed Cdn resident. ***Now.

Normally don't think ITA applies to 2 NRs, except if NR borrower carrying on business in Canada and deducting interest in Canada. Then deemed to be Cdn resident and withholding tax follows. ***But only where "amount was deductible in computing that NR's taxable income earned in Canada" – **Easter Law**: much difference in computing income versus taxable income. S. 115 and 116 is the sections where calculate NR taxable income. Capitalized income (cost of goods sold) not deductible in computing taxable income. Are deductible in computing gross profit, so not deductible in computing income or taxable income.

Easter Law Trust [2005] TCC

F: NR borrowed money from another NR to build condos in Canada. Did not deduct capitalized income. D: TP won.

Review tax principles: When Cdn taxpayer borrows money and must pay interest, if interest is for gaining or producing income, deductible (20(1)(c)). But another provision: If TP borrows money for purpose of financing construction, interest cannot be deducted (in response to MURB) as an expense; it bumps up cost of ppty (cost of goods sold).

Here, ELT was capitalizing interest and then had to pay interest to lender once construction finished and started selling condos. CRA: All interest paid attracted withholding tax. ELT: Didn't actually deduct interest. Reduced profit (bc deducted cost of items sold), but deductible in calculation of taxable income.

D. Rents and Royalties

212(1)(d): 25% payable to NR who is paid or credited rent or royalty or similar payment including, but not restricting the generality of the foregoing, any payment:

(i) through (v) specific things. But not including a payment made for services performed in connection with the sale of ppty or the negotiation of contract: (vi) to (xi) – things excluded. If excluded, no Part 13 even though in a sense a rent, royalty or similar payment. *If rent or royalty, see if specific provision. If not, see if caught by general

phrase. VK: Rent includes not only use of real ppty but also personal ppty [United Geophysical].

Transocean Offshore [2005] FCA

212(1): Amt paid or credit as or an account or **in lieu of** or satisfaction of:

F: NR1 (TP) indirectly controlled by NR2 (who indirectly controlled NR1) in business of offshore drilling rigs. Others enter contract with TOI to charter drilling rig owned by NR1 off Cdn cost. In contract, others had to pay daily rates to TOI each day rig in use and for upgrades. Others decided not to go through and settled with TP and TOI where other paid \$40M. Others withheld \$10M and remitted to Minister. CRA argues (d) applies. D: TP lost. Ratio: TJ finding of fact: damages compensated TP for rent that would have been paid under contract if not repudiated. Nature of payment made **in lieu of** rent. Did not rebut Minister's assumption of fact. Encompass amts paid to compensate for rent, when contract is repudiated before commencement. *Problem bc didn't call any oral E. *In lieu means instead of or substituting for something else – Parliament would not have used that if didn't mean something other than legal rent. *French version did not help.

DS: Would expect thing would be used, however language states “use or right to use”. Could they have structured agreement elsewhere? Tailor settlement agreement with window dressing. SCC leave of appeal denied on Oct. 13.

Example: NR landlord apartment in Canada annual rent \$1M. Borrows money, ppty tax, insurance, ad fees. Expenses \$0.9M. Profit \$100K/yr. Tenants pay rent directly to NR landlord (see no Treaty reduction for rent). Withholding tax? \$250K. Where get \$ for other \$150K?

Alternative mechanism for NR landlords: 216(1): Allows NR to file a return and pay regular (Part I) tax on net income from real ppty in Canada (roughly 50%) rather than a flat 25% on gross (214) income. Under 216(d), personal creditors are not allowed, but graduated rates under 117(2) will apply if NR is an individual. Views doc 2004-0095441E5: Election applies only to amounts actually paid, not those accrued.

215(3): Where amount paid or credited to agent of NR without tax withheld under Part 13, agent must deduct tax and remit. Thus, NR landlord often retains property manager in Canada. 212 says only withholding tenant if paying NR. Thus, if tenant pays agent, not responsible (agent must deal with withholding tax issue).

216(4): Optional method of payment: If NR files undertaking to file tax return within 6 months of YE, NR agent relieved of withholding except amounts it pays or credits to NR. Often agent collects rent, pays expense, then net to NR. *Can make tenant agent if little house. Problem: If NR fails to file return or pay tax, agent on hook for amt that should have been withheld if had been no NR. DS: Harsh.

Article VI: Rent on real ppty. Nothing reduces the 25%. Canada jealous.

Royalties: Article XII: Para. 2: Withholding reduced to 10% owner in other state is beneficial owner of such royalties.

Syspro Software [2003] TCC

F: S Ltd. (Cdn TP) licence with NR acquiring right to reproduce software and sell to customers provided they sign agreement they won't reproduce. S Ltd. paid royalty to NR for every customer, but did not withhold any tax under 212(1)(d). D: S Ltd. won.

Exemption in 212(d)(vi): royalty or similar payment on or in respect of a copyright in respect of the production or reproduction of any literary, dramatic, musical or artistic work. In other case, Bowman: software literary work. CRA: Reproduced software, then sale so caught under (i).

Ratio: S Ltd. won. All one transaction and most critical aspect was reproduction. Sale only incidental so it qualified for exclusion. Thus, exempt. *Complicated – facts of each case. Doesn't mean any time you pay for software, don't have to pay withholding tax. ***Here, unique bc each reproduction constitutes separate royalty obligation. TCC: If S Ltd. used property for its own accounting, would have attracted Part 13 tax. ***exemption does not apply to payments by end-users to NRs.

E. Dividends

212(1): says paid or credited or deemed by Part I to be paid or credited.

212(2): Every NR person shall pay income tax of 25% (like withholding) on every amount a Cdn corp pays, credits, or is deemed to, to NR as, on account or in lieu of payment of, or in satisfaction of,
(a) taxable dividend or (b) a capital dividend. Weird: Deeming.

Article X: Rate reduction. Para. 2: If fit within (a), where NR SH is a company and if that company owns at least 10% of voting stock of Cdn company that pays dividend, withholding tax **only 5%**. If any other situation, 15%. Interesting: withholding rate on interest and royalties only 10%. *Much variation in Treaties: e.g. director 25% SH req't.

Placements Serco [1987] FCA

212.1: Complicated; where NR transfers shares of a Cdn corporation to another Cdn corporation to which NR is NAL. Will trigger deemed dividend: amount FMV of consideration that exceeds PUC.

F: TP transaction with deemed dividend and did not withhold and reassessed. Argued 212(2) applied to real dividend not deemed dividend. D: Deemed dividends are caught.
*Warning: if deemed dividends going to NR, still potential for withholding tax issue.

VII. INCOME EARNED OUTSIDE CANADA BY CANADIAN RESIDENTS

ITA, s. 2(1), 20(11) & (12), 122.3, 126(1), (2), (6), (7)

Interprovincial Pipe Line [1968] SCC

Dagenais [2000] TCC

FCIT, p. 93, 258, 636-637, 647-653

A. General

Basic Rule: If earn income outside Canada, generally subject to tax under s. 2(1) [worldwide income]. *Only Cdn resident, not where Cdn resident sets up corp in another country. What about tax payable in foreign jurisdiction? Policy: Want Cdn residents to earn money elsewhere bc spend here and need to internationally competitive when bidding on contracts. 3 main techniques in ITA one might compensate for double taxation:

1. Oversees Employment Tax Credit (OETC). 122.3.
2. Foreign tax credit (FTC).
3. Foreign tax deduction (FTD). Deduct in income or taxable income. If reduce income by a \$1, tax savings if only 20 or 30 cents bc that's tax rate.

B. Oversees Employment Tax Credit (OETC)

122.3: OETC effectively allows a qualifying Cdn resident individual to eliminate 80% of Cdn tax on first \$100K income earned on an overseas project throughout any period of more than 6 months commencing before the end of the yr and included any part of the yr. E.g. AB, 40% so \$40K tax. OETC (80%): \$32K.

*Must be employed by "specified ER" [122.3(1)(a)] (not IC) and EE must perform all or substantially all of his duties outside Canada [122.3(1)(b)]. Does not say must be outside Canada for 6 months. Meaning? If commute from Windsor to Detroit, bulk of work outside Canada. Duties performed must be in connection in where ER carried business outside Canada:

1. Exploration for petroleum, natural gas, and similar resources.
2. Construction, installation, agriculture, engineering.
3. Prescribed activities (e.g. UN Contracts). Or landing that type of contracts. E.g. Going to try land someone to come work in oilfield.

Specified ER: means ER resident in Canada or partnership of which 90% of partnership interests owned by Cdn resident or foreign sub in Canada. Must be a Cdn connection.

*Sucks if work outside Canada and don't have Cdn ER.

*Specified ER must carry on business. **Timmens:** A non-profit organization can carry on "business" for purposes of 122.3. Here, province of NB work in Africa to do paid work (but not expecting profit). First, gov't trying to recover its costs. Second, business includes an undertaking of any kind whatever. ***CRA doesn't like case, so if EEs working for NGOs or government, be careful.

Overseas a misnomer: it can include the US and can apply to an EE who lives in Canada and commutes across the border daily (**Purves**).

*If work for 5 months and mom ill, too bad. Vacation or reasonable short periods not be a problem if that is part of normal routine of work.

Rooke: F: R set up numbered company and entered contracts where R EE of corp. In 1993, in Canada 9 days, US 19 days, back 20 days, US 109, then Taiwan. Didn't spend 6 months non-stop. While here, sent e-mail or fax but bulk of work overseas.

D: TP won. Don't start 6 month period every time leave Canada. Need only for 6 months perform all or substantially all of your duties outside Canada. 90%.

Ratio: Require 6 consecutive months, but do not require physical absence from Canada for 6 consecutive months. Interpretation Act: singular includes plural and plural in singular. Says contract, but can read it as plural.

C. Foreign Tax Credit (FTC) Dollar for dollar reduction in Cdn tax itself.

126: In general terms, a FTC allows a credit to a Cdn resident for foreign income tax paid on foreign-source income, up to a limit of the Canadian tax on that income determined on a proportional basis. The effect is that the TP pays total tax equal to the higher of the two rates (Cdn or foreign) on foreign source income.

*Calculated on country by country (don't lump).

126(1) deals with non-business income such as dividends on which foreign tax was withheld. "non-business income tax" defined: not exceeding amt of Cdn tax that would have been payable. E.g. \$50K foreign tax, Canada would have taxed \$40K. Only \$40K credit. If \$36K foreign tax, must pay \$4K Cdn tax.

*Must be foreign tax paid by Cdn resident. If TP foreign affiliate who pays tax, not is credited under 126 – 126(1)(a).

126(7): Non-Business income tax: Tax paid to foreign jurisdiction on investment and other non-business income. Must income or profits tax; if tax on capital, not qualify.

126(6)(a): "Foreign gov't" includes political subdivisions of foreign gov't. E.g. States in US, but not city of NY.

*** Employment income can fall under this. But if claim OETC, cannot get FTC.

*Cannot if use deduction

*If EE, Article IV, para. 2(a) may apply.

**No carryover.

126(2) Business income tax: Cdn resident carrying on business in a country other than Canada (like branch operation), TP may deduct from Cdn tax an amount not exceeding least of several items:

126(7): "Business income tax" actually paid to country that may be reasonably required as income.

126(2)(a): Can carryforward unused FTCs for 10 yrs and carry back 3 yrs. 126(2.3): Must deduct Must deduct current year's FTCs before use previous years.

126(2)(b), 126(2.1): Amount of Cdn tax payable on comparable income paid in Canada.
126(2)(c): Must deduct non-business income tax credits before deduct business income tax credits.

D. Deduction

(not credit). Situation where can't get FTC. Treat as operating expense. Rules in 20(11) and (12). Example: Assume \$100 Cdn income and paid \$25 of foreign tax and subject to 40% rate in Canada. If FTC, say \$40 tax payable and deduct \$25 FTC, so remit \$15 to Canada. If don't qualify for FTC, deduct \$25 of foreign tax. \$75K so pay 40%*\$75; plus, must pay foreign tax. So not as generous as FTC.

20(11): Deduction only applies to ppty income (rents, dividends, etc) not business. May deduct tax in excess of 15%. First 15% pay to foreign country, can't deduct. If over 15%, can deduct. Also can't deduct for income from real property and any deduction you make will not be able to get a FTC.

20(12): Business and ppty income. All you can deduct is non-business income tax. Start with FTC, but if limitation rules lock you from claiming FTC, get partial relief here.

Dagenais [2000] TCC

F: D had 2 US endeavours. US taxed lottery winnings, but not tax his CGs on securities. D was Cdn resident, not US resident. Treaty said since sold shares (not gain from real ppty), tax exempt. Canada opposite; not tax lottery winnings, but securities taxed. Double waxed. Paid \$36 US tax so wanted a credit.

D: Lottery winnings not a source of income so can't get FTC. D tried under 126(1) and 20(12) and Proulx took same position for both positions. Says "income according to Cdn law". Since no source, can't. DS: Didn't go through rules in 126. (1)(b) has a formula.

Interprovincial Pipe Line [1968] SCC

F: IPL gross revenue of \$2.4 million, but real profit only \$57,000 bc used borrowed money to buy bonds. Language different but still had to figure out amount of Cdn tax payable on income. IPL: income from US so limit was foreign tax payable on the income, so roughly \$1 million (well in excess of foreign tax it paid). Foreign tax authorities: No, must look at net income, only \$57K and Cdn tax on that roughly \$25K so only get a small portion. D: TP lost.

Reasoning hard. Focused on s. 139 (just enacted). TP had won 1959 tax yr. Parliament amendment effect in 1960; provision now found in s. 4; take all revenue and expenses from source and net two together and that is your income.

SCC: Matching rule now in s. 4 requires you to take interest revenue and deduct interest expense (which is small). Then take Cdn tax on that amount and that is limit on your

FTC. Ratio: Use **net** income amount. *Claimed Treaty protection. Similar provision now in Art. 22, para. 2(a). Says when each country agrees to apply its regular foreign tax credit rules in accordance with normal domestic rules. DS: Thus, Treaty doesn't help much as it is deferential to the rules in Canada and the US.

VIII. TAXATION OF CERTAIN FOREIGN ENTITIES

A. FOREIGN AFFILIATES

ITA, s. 90, 91(1), (4), (5), 93(1), 95(1), 2(a), (a.3) & (b), (3), (4), 113(1)

ITR, s. 5900-5902, 5907(1), (11)-(11.2) (skim)

Canada Trustco [1991] TCC

FCIT, p. 1299-1327

S. 90 through 95 complex. Also Part 59 of Regulations. Getting superficial analysis.

Key points: FA rules distinguish between active business and passive investment income earned outside Canada. Treat active favourably; passive treated badly (must report immediately even if earned by FA). Parking investments offshore not treated nicely by CRA. Discussion on "income earned outside Canada" by FAs.

"FA": Corporation set up in foreign country and the SH owns shares in that company. Thus, FA earning income versus Cdn corporation earning income. Rules required investment income to be taxed in Canada year earned (no deferral). Planning to make active.

Application of rules: Relate to a variety of factors:

1. Type of income. Active or passive.
2. Relationship between foreign entity and Cdn SH. Let's call it ForCo (since may not be FA). % of ownership owned by Cdn SH? Is Cdn an ind or corp and what type of corp.
3. Timing of repatriation of foreign earnings. Deferral permitted for active, not passive.
4. Application on relevant Tax Treaty (won't focus on).

1. Type of income. 3 types and third has 2 categories.

(i) Business income. (ii) CGs. (iii) Investment income: (a) Portfolio dividends (dividends from corporations where foreign company owns < 10%); (b) Passive income from controlled FAs.

2. % of ownership. 3 ranges of ownership. (i) < 10%; Cdn SH pay tax on dividends only when paid out (Kristna: remittance tax); (ii) 10% to 50%; then generally corp will be a FA (more req'ts must be met); if active business income, Cdn SH need only worry about Cdn tax when dividends paid out to Cdn SH; (iii) > 50%; Cdn SH in a control position ("Controlled Foreign Affiliate", CFA). When CRA status, FAPI (Foreign Accrual Property Income); NOT good! Even if pay no dividends, must still include in your Cdn IT return income. Whole focus of rules: promote Cdns carrying on business abroad but preventing sheltering of income abroad.

95(1) defines “FA”. 2 part test: 1. Look at TP (always referring to TP resident in Canada). Must have equity percentage of 1% or more. Discuss equity percentage later. In addition, total of equity percentages of TP and all related persons must be 10% or more. Example: H 1% in USCo and W owns 9% of USCo [husband and wife related]. Take it for now represent equity percentage. Tf, H satisfies 1% and 10% rule. Thus, USCo is FA of H and W. What if H 0% and W 10%; FA of W but not a FA of H.

“FA” Means a NR corporation. Tf, must be a corporation. Issue of whether a creature of a statute of a foreign jurisdiction is a corporation. Must determine if foreign entity is a foreign corporation for purposes of Cdn law (English CL). Corporation: entity separate and apart from its owners, indefinite or perpetual existence unless take active step to wind them (not limited liability bc now LLC). CRA: List of entities thinks are corps (IT-343R). Once know corporation, figure out 1% and 10% equity percentage.

“Equity percentage” defined in 95(4): 2 key terms defined: “direct equity percentage” and “equity percentage”.

Equity percentage: Total of person’s direct equity percentage in the corporation and indirect equity percentages (not defined – look through concept) by multiplying person’s equity percentage Holdco by other person’s equity percentage in particular corporation. Must do a look through. E.g. If own 50% of CoA which hold s 10% of shares of CoB, then indirect holdings of 5%.

Direct Equity Percentage: Formula. Look at each class of shares that corporation might have issued. Determine TP’s percentage ownership of that class. Which class does TP have highest % ownership? Whatever that is becomes the DEP.

Example: CanCo owns 25% Class A and 50% Class B of NR1 (don’t know other SHs), 5% of NR2. Also NR1 owns 30% of NR2. NR2 owns 15% of NR3. I: Which are FA of CanCo? What is equity percentage?

In NR1: DEP: Look at each class the TP owns; 25% and 50%. The DEP is whichever is higher. Thus, the DEP is 50%. Tf, NR1 is a FA. We own more than 1% so don’t have to worry about related parties (can use Holdco).

In NR2: DEP: 5%. Equity percentage: Take total of direct %s and indirect %s. Direct is what you actually own of 5%. Indirect ownership (not defined but look at each corporation at what you have an equity percentage by the direct). Here CanCo has 50% direct % in NR1 and NR1 has 30% interest in NR2 so 15%. Thus, equity % of 20%. Thus, NR2 is a FA.

In NR3: DEP: 0%. Indirect: $15\% \times 20\%$ (as above) = 3%. FA? Equity percentage must be $> 1\%$; yes, 3%. Also, TP and related persons collectively must have a combined equity percentage of 10% or more. If you assume that the other 85% are owned by unrelated parties, then not a FA. Can change: Suppose put SisterCo that’s related with CanCo. And

SisterCo owns shares of NR3, the minimum of shares SisterCo would have to own of NR4 is 7%. Thus, 10% so NR3 is a FA of both CanCo and SisterCo.

***Whenever discussing FA, must always do it in the context of a Cdn TP.

Error on P 1306 Kristna: In discussing NR1, says NR1 is a CFA of CanCo. Prof doesn't think quite that simple – need to look at voting shares.

FCA: In rough terms, corporation in which a Cdn resident has > 50% of shares of foreign corporation. Def'n in 95(1): "CFA" Complicated. 2 different amendments to revise definition of FA. Start on 3 lines in white: "controlled by" then a grey box, then look down at application Oct 31, 2003 notice of ways and means motion to amend the provision. Then white space and then long grey area with different def'n and different parts amended. Reverted to 2003 version (in essence) instead of proposed 2004 version. But bc some people relied on 2004 version, that will apply for a few months.

CFA: Cdn TP must have a FA (if no FA, no CFA). CFA must be a FCA 94.1(2)(h) [allows election of FA status] or FA controlled by – not back to white paper. If have any one of these 5 situations of control, now have FCA;

(a) FA controlled by TP.

(b) If control of the TP and 4 or fewer other persons resident in Canada. No req't of connection between those 5 persons and doesn't have to be.

Example: ForCo has 5 SHs: A(10%), B(10%), C(10%), D(10%), E(10%). Assume all unrelated. No control so ForCo is not a CFA of any of those people. Now give A 10.1% so now ForCo a CFA of A. Why: prevent group of buddies setting up offshore investment company. Is ForCo a CFA of E? Yes, bc still 4 others who collectively own > 50%.

(c) If 4 persons control and as long as TP is a FA, still FA yourself. Example: X(10%), Y(51%). Y controls ForCo. Tf, ForCo is a FA of Y. As long as ForCo is a FA of X, then ForCo automatically becomes a FCA of X. (d) and (e) pick up other situations with spouses, parents, and other related persons.

95(2)(u) to (x): Look through rules. If Holdco, partnership, or trust own shares of foreign corporation, can look through them and attribute back to the Cdn. *Doesn't help to put other entities between you and foreign corporation.

Specific resident rules apply to FA. Only mention one: FA resident in a particular country must keep its tax accounts in currency of that country. **Reg 5907(11.2):** Rule indicates where a FA is resident. If the FA is resident in a country in which Canada has a tax Treaty, then FA will not be treated as resident in that country unless it is actually a resident of that country for purposes of the Treaty. Also, if FA would be resident in that country if it were treated as a body corporate for purposes of the Treaty; put in Regulation to deal with LLCs. Canada says US LLC not a resident of US for Treaty purposes, but rule allows you to treat LLC as a FA for Treaty purposes.

95(6): Anti-avoidance rules: Can play games when talk about control and share ownership. E.g. Options to buy. Or may acquire shares simply bc want favourable

treatment of FA. Section allows CRA to treat you as owning shares or disregard the shares you bought.

What happens when a FA earns income and wants to pay a dividend back, beginning with income generated by a real business (non-FAPI): 12(1)(k): Rule requires dividends from FAs to be included in computing income. 90: More specific: Cdn resident is taxable in respect of any dividend received from a foreign corporation and include it in your income on the yr you receive. If foreign corporation, could be a FA, depending on type of income and source of income.

Rules of Thumb: Context: CanCo (could be ind.) owns shares of FA (corporation set up in country other than Canada). FA earns business income, may be subject to tax in that country, and ultimately pays a dividend up to Cdn SH. If FA in country in which Canada has a tax Treaty and income earned in designated Treaty country, then when that income comes up to Cdn SH (assuming corp) will not pay any tax in Canada (very favourable treatment). If business income earned in a non-Treaty country or corporation not in Treaty country, there's recognition in Canada for the tax paid in the foreign country.

Reg 5901: When a corporation that is a FA pays a dividend, treated income as coming from 3 possible surplus accounts: exempt surplus, taxable surplus, and pre-acquisition surplus (just book-keeping entries). If dividend comes out of exempt surplus, its included in income under s. 90 but fully deductible under s. 113, with result of no net tax in Cdn SH (if corp). If dividend paid out of taxable surplus, then dividend included in income but a credit is available for the underlying foreign corporate income tax or withholding tax. If paid out of pre-acquisition surplus, the dividend is included in income but fully deductible including taxable income, but the amount of the dividend reduces the ABC of shares.

When FA pays out a dividend, it's deemed to be paid out of exempt surplus (good), then taxable, then pre-acquisition. Need not make election.

Reg 5907(1): Defines exempt surplus: Refers you to def'n of exempt earnings, which refers to def'n of earnings. Summary: In general terms, it refers to active business earnings from a business carried on in a DTC (Designated Treaty Country). Why favourable treatment? Assumption any country with Treaty with Canada has a tax system and will impose tax (so not a tax haven). Assumption breaks down in some countries (Barbados, Cyprus, Ireland, Malta, Switzerland, DTCs with low tax rates are called "Treaty havens"); look tax there and everything back can be an exempt surplus dividend. Basic components to exempt surplus (only in current context, not before 1970s): (1) Net earnings (net of tax and expenses) from an active business carried on in a DTC or Canada (e.g. FA sets up branch in Canada and earns income here – branch subject to tax but after-tax income is exempt surplus); (2) Tax-free half of a CG; (3) Dividend received out of the exempt surplus of some other FA (e.g. FA2); (4) To extent you have losses from FA, reduces exempt surplus; (5) To extent you pay out dividend from exempt surplus, exempt surplus reduced.

90: TP, corp or ind resident in Canada, includes the dividend in 'income'. 113(1)(a): Can deduct amt of dividend in computing 'taxable income' provided it's out of exempt surplus.

Taxable Surplus: Generally refers to active business income earned in a non-DTC. Reg 5907(1): (1) Net earnings from an active business carried on in a non-DTC (exclude Canada); (2) Net FAPI; FAPI less foreign tax paid wrt that income; (3) Taxable half of CG on ppty used or held principally held for earning income in non-DTC; (4) Dividends paid out of the taxable surplus of other FAs; (5) Losses reduce taxable surplus; (6) Reduction when pay dividend out of taxable surplus.

90: Include in income. 113(1)(b): Cannot deduct full amount of dividend, but can deduct an amount that really represents that portion of foreign taxable surplus income that was subject to tax, more or less at the same rate it would have borne if earned in Canada. Determine your foreign income in non-DTC and foreign tax paid on that and then multiply that by Relevant Tax Factor (RTF - 1). Example: Assume foreign income of \$1K and foreign tax 20% so \$200 tax. Tf, \$800 dividend. Calculate deduction: $RTF=3$. So $200*(3-1)=\$400$ deduction. Thus, $\$800-\$400=\$400$ of taxable income (and pay Cdn tax at rate of 35% so \$140). Tf, $\$200+\$140=\$340$. If earn directly in Canada, \$350 tax.

*FA rules will not weigh heavily on examine. Will ask if particular corporation is a FA or CFA. Won't go through the calculations.

113(1)(c): Dividends from taxable surplus that is subject to a withholding tax. Say \$800 dividend and country of FA has 10% withholding tax. Thus, net received is \$720. Apply foreign withholding tax and multiply by RTF (not subtract 1). Why? Cdn resident will be treated as receiving \$800 dividend. Thus, $\$80*3 = \240 . Foreign tax \$100, Foreign withholding \$80, Cdn tax \$57 ($\$800-\640 , then $*.35$).

95(1): RTF: $[(1)/(\text{tax rate})]$.

Pre-acquisition surplus (PAS): No defined in ITA or Regulation. It is a residual surplus; whatever remains after the FA paid out all its exempt and taxable surplus (still has equity remaining). Includes earnings of a corporation accumulated before the taxation yr in which the foreign corporation became a FA of the Cdn SH. E.g. UK corporation with \$1 million in RE and then Canco buys it. FA with RE before 1972 go into pre-acquisition surplus.

90: Include dividend in income. 131(1)(d): Entire dividend from PAS is deductible in computing taxable income. 92(2): Grind in ACB. If ACB goes negative, then negative portion constitutes a TCG.

FAPI

Policy: While gov't happy to have Cdn carry on business abroad, don't want Cdn from investing their saving where they don't have to pay tax on their investment income. If

they do, Cdn gov't expects to collect tax on the foreign investment when it is earned (not when brought back to Canada).

Basic Rules: 1. 95(1) defines "FAPI". Proposed 248(1) def'n that FAPI means FAPI in 95(1).

2. Apply only when FAPI is earned by a CFA. If FAPI earned by regular FA, bad things of FAPI will not apply; FIE rules may apply (below).

3. 95(1) formula defines FAPI: (a) income from property other than dividends received from another FA; (b) TCGs on dispositions of ppty other than excluded ppty. "Excluded ppty" defined; ppty used to carry on an active business (good thing).

4. Item A also includes income from businesses other than active businesses.

Deduct in computing FAPI: Item D: Losses from ppty and losses from non-active businesses (opposite of Item A). Item E: Allowable CLs from dispositions of ppty other than excluded ppty. Thus, netting effect. Item F: Certain other losses.

What is an active business? Some differences in normal corporate def'n. 95(1): Active business: Any business carried on by a FA other than an investment business (defined) or 95(2) business deemed to be other than an active business.

95(1): Income from an active business: Includes income that pertains to or is incident to the active business, but does not include income from ppty or any 95(2) deemed not active business. "Income from ppty" includes income from an investment business or income from an adventure or concern in the nature of trade (speculative). Income from ppty does not include income deemed to be income from a business. *Just know general concepts, not the detail*

"Investment business" is a business that generates income from ppty (interest, rent, dividends, royalties) from self-insurance or income from factoring A/R or income from dispositions of investment ppty. Major exception if 3 req'ts met: (1) Customers of business must be arm's length parties; (2) Business must be a regulated financial business (banking or insurance) or the development of real estate; (3) Must have more than 5 full-time EEs (typically means whole numbers). ***Req'ts put in place after Canada Trustco. On facts, Canada Trustco will no longer work.

95(2): 1. (a) deemed ABI (good). Example: Amt payable by one FA to another FA where there is a qualifying interest (10% of votes and value) and amt payable is deductible in computing the payor's business income. Example: Canco owns 100% of Opco (foreign corp) and 100% of Finco (foreign country) and 100% of Opco2 (another country). Often financing needs for various corporations in offshore jurisdictions. Decision made to set up a foreign finance company. Finco may loan money to Opco which will pay interest back to Finco. Interest normally deductible in other countries. To qualify 95(2)(a), there must be a NAL relationship. Here, yes, qualifying interest. Finco interest will be classified as a deemed ABI so get exempt surplus (bc now ABI, not FAPI).

2. (a.1)-(a.4), (b): deemed non-ABI: Generally aimed at items that have a source in Canada. Suppose Finco also lends money to Sisterco (in Canada). Interest to Finco will be FAPI. Why concern: Sisterco gets interest deduction.

“Excluded ppty”: ppty used principally for the purpose of gaining or producing income from an active business, or shares of another FA (or subsidiary) whose ppty is 90% or more attributable to active business. Tf, good thing bc gains not FAPI.

FAPI: Essentially investment income earned in a country other than Canada.

Tax Consequence of FAPI: 95(1): If TP resident in Canada and hold share of CFA, must include in your income your proportion (participating %) of CFA’s FAPI, whether corp or ind. “Participating percentage” defined in 95(1): If FA has total FAPI for a particular year of \$5K or less, then the participating % is nil. Must be associated corporation rules or something. If > \$5K FAPI in a year and one class of shares, just take % of your shares and that’s your FAPI. What if own common and a few classes of preferred shares of CFA (some right to dividends, some not)? Regulations tell you your share of FAPI.

If FA, good chance it will be paying some foreign tax. 91(4): If FAPI included in your income under 91(1), can deduct an amount from the income inclusion equal to product of the foreign accrual tax (any income tax you paid on foreign income) multiplied by RTF (3 if corp, 2.2. if ind, but not subtract 1).

If have FAPI, must pay tax on it while it is earned in the CFA. Example: Canco owns 100 shares of CFA with \$100 ACB. CFA earned \$500 of FAPI, but decided not to pay dividend. Assuming tax haven, \$500 included in Canco’s income. Assume Canco decides to sell shares, purchaser will pay enough to recognize \$500 still in FCA so assume \$600. Thus, if ACB is \$100, CG is \$500. Not fair since already included \$500 in FAPI. 92(1) and 53(1)(d): If include FAPI in income, bump up ACB equal to FAPI. Thus, ACB \$600 so CG is nil. Problem: Eliminate the gain, but included all FAPI at regular rates (no half CG).

Example: Suppose no sale, but instead had 91(1) FAPI inclusion in year 1. Want cash in yr 2 so pay dividend from CFA of \$500 to Canco. Not out of exempt surplus bc it was FAPI (certainly not ABI from a DTC). Will come out of taxable surplus (net FAPI). Tax haven so \$0 foreign tax (*RTF is \$0 so no deduction under 113(1)(c) or (d)). Get \$0 deduction under s. 113. Fair: 91(1) \$500 inclusion and 90(1) inclusion of \$500. Not fair. If tax FAPI earned offshore, what do when pay dividend out. 91(5): Can deduct lessor of 2 amounts: (1) that portion of the dividend that is not deductible under 113 (here, none can be deducted under 113 - \$500); (2) ACB bump (\$500). Here both \$500. Numbers won’t be the same when foreign tax involved. Tf, got money up tax-free. But now FMV \$100 with ACB \$600. But grind to ACB to \$100.

Canada Trustco [1991] TCC *Amendments after decision.

F: Get them. Major income: loans to other corporations in CT group and interest from bank deposits. Thus, much interest income. FA (BV incorporated in Netherlands) did not have many EEs (no more than 4 or 5) but none full-time. BV did not have its own office (using space of other affiliates). I: Whether FA had active business or FAPI?

D: Active business income. Case decided after domestic cases on ABI. These held; corporate TP's raison de-etre is to create business (since then ITA amended). CRA argued ICs not full-time EEs; Ct said it doesn't matter. CRA argued loans to related parties: Ct said too back. Can still have business. Funds in bank account were necessarily incidental to the business (today, no). Tax plan: Para. 15: Interest income earned tax-free in Netherlands. BV lent money back to Canada, interest paid from Canada to BV and Treaty then had no withholding tax on interest. Thus, deduct interest for Cdn purposes, no tax on way out, no tax on Netherlands, and taking money and lending to US. Para. 19: Under US-Netherlands Treaty, no withholding tax on interest from US. Capital in Netherlands and interest payments from Canada and US (high rate) and deducting the interest paid there, no withholding tax on way out, and tax-free in Netherlands. Nice plan. Now, took out Netherlands no withholding tax. Also no FAPI; BUT THOSE DAYS ARE LONG GONE.

2 rules will kill Canada Trustco result: 95(2)(a.3): deems payments non-ABI and put in FAPI. Also, must have 6 full-time EEs to make this work. *If loaning to your own FAs for use in active business, need not have full-time EEs.

Exam: Simple and won't get into detail.

IX. USE OR MISUSE OF TAX HAVENS AND TREATY HAVENS

ITA, s. 111(9), 245, 248(1) "treaty-protected business" & "treaty-protected property"

Income Tax Conventions Interpretation Act, s. 4.1

Crown Forest [1995] SCC

Univar [2005] TCC (don't read)

FCIT, p. 109-111, 1003-1034 (skim), 1396, 1715

No definitive definition of tax haven; typically, country that has no tax or low rate of tax for certain people. Canada from a fiscal point of view hates tax havens and rarely enter treaties with them, called by Treaty-haven. My have hefty tax rates for its own citizens.

Treaty-Shopping: TP looks for Treaty relationships between different companies and structure investment to take advantage of Treaties. Resident of one country (say Canada) will create a sub resident in another country. The sub can take advantage of a Treaty that country has with a third Canada. Typically, the Treaty between Canada and the third country does not have the same advantages. E.g. **Canada Trustco** (succeeded) and **Crown Forest** (attempt but failed).

Crown Forest: Para. 55, 57, 58. Treaty shopping is not improper. However, it is not to be encouraged or promoted by the Cts.

Canada-US Treaty: Article XXIX – A. Protocol: When US applies Treaty, the benefits of the Treaty are confined to “qualifying persons”. They will give benefit of Treaty of Cdn resident with connection to the US, provided the Cdn resident is truly connected to Canada (citizen, owner). If France using Cdn corporation, US may use this article to deny the benefit to the French-owned Cdn corporation. Nothing gives Canada the benefit. Technical Interpretation: Bc Canada tends to rely on GAAR to counter treaty shopping.

CRA: S. 245 – GAAR: If a TP obtains a tax benefit (any reduction in tax or increase in refund and the like) through transaction with no bona fide purpose other than to obtain the tax benefit, CRA can assess the transaction as if the tax benefit is not available. Overriding proviso: 245(4): General rule that allows CRA to do bad stuff to you (see grey box – not enacted). GAAR will only be applied if only it would reasonable: directly or indirect misuse of ITA, Regs, and Tax Treaty. Old wording: Said for greater certainty. Current law: For greater certainty, it is amended. Applies to transactions after Sept. 12, 1988 (retroactive).

Income Tax Conventions Interpretation Act, s. 4.1: Hereby declared that s. 245 of ITA applies to any benefit provided under the convention (retroactive too).

248(1): “Treaty-protected business”: Business in Canada owned by NR and whose income will not be subject to tax bc of a tax Treaty.

248(1): “Treaty-protected ppty”: Same as above except ppty.

111(9): If NR person, in computing the losses of NR person, cannot include any losses from a Treaty-protected business or Treaty-protected ppty. If don’t pay tax when make money, then can’t use losses to offset a winner that is subject to tax.

Univar [2005] TCC (don’t read): U Ltd. (Canada) sets up wholly owned sub B Co. (Barbados). N Ltd. (Netherlands – NR finance company) owned loans affiliated corporations of U Ltd. B Co. bought the loans, so now creditor. All debtors pay interest to B Co. Debtors do active business, so not FAPI to the creditor. Thus, ABI in B Co. Barbados is a DTC (designated treaty corporation) with ABI so exempt surplus. B Co. would pay dividends to U Ltd.; since out of exempt surplus, no tax.

CRA challenged: 95(6) Specific anti-avoidance rules for FAs and s. 245. D: The taxpayer won. To have a tax benefit, there must be a reduction – can’t reduce if paying zero tax. U Ltd. said where is our tax benefit. Back when N Ltd. owned the loans, they were not getting any income. CRA: Tax benefit is that if B Co. didn’t acquire loans, but rather U Ltd. bought loans, then interest to U Ltd. U Ltd. argued they would have just stayed the way they were. D: No benefit.

MIL (Investments) SA: SA ending used in France, etc. Treaty shopping. CRA challenged TP on 2 grounds; (1) Treaty abuse; and (2) GAAR. Decision may come out soon.

X. INTERNATIONAL TAX PLANNING

A. FORM OF BUSINESS ORGANIZATION

ITA, s. 219(1), 219.1, 219.2, 219.3

FCIT, p. 1353-1363, 1376

Focus on vehicle to use if new cross-border business or investment. Corp, partnerships, branches.

US Corp and want to expand into Canada. Branch (US entity no corporation and just starts to operate), ABULC, Cdn subsidiary, commercial trusts, joint venture (2 venturers, Cdn and US), partnership.

Branch: Thus, US entity uses PE or no PE. Treaty “PE”: Ask what business they do. If sales, maybe don’t need PE (agent). Remember if agent habitually exercises power to bind you, then PE (put contract). Then all your income might be treaty exempt. If manufacturing plant, definitely PE. [side note: If PE is money lending business, then passive income – Part 13]. Assume active business income. Remember branch is the same legal entity as the head office, so payments up won’t have part 13. Branch tax. But first \$500K not subject to tax.

ABULC: The ULC is treated as a tax-flow through from IRS view. But have to tell them to talk to their US lawyers to get advice if they want free flow.

Subsidiary: It is a Cdn taxpayer. Not a CCPC. Pay regular top rates for corporate purposes. Then after-tax profits dividends out to parent – withholding tax. Treaty reduction to 5%. But first \$500 still subject to withholding tax. But might get a full US tax credit, so might not care.

Non-tax: Subsidiary gives liability protection – don’t want to expose all US assets to lawsuit in Canada. Employment issues if hire EEs.

Suppose person is a ppty developer, specialize in building office towers. Want to build one in Edmonton for rental income. Want to borrow extensively, but have some equity. Part 13, or can you file under 216 election. 216.4 – get Cdn ppty manager to collect the rent. If don’t want withholding tax, set up a Cdn sub to create office. But will be withholding if sub borrows from a non-Cdn lender. But can get 5-yr loan at arm’s length (not parent). If make money, withholding tax on dividends when pay out.

These were inbound investments.

Outbound: Cdn client wants to expand outside Canada. If branch, taxed on worldwide income. Incorporate a US corp in Delaware and explore FA rules. If client in manufacturing and sales, likely ABI so likely exempt surplus. Won't want to invest surplus money in US (no, unless really good investment).

Suppose client is individual and likes idea of US corp. Who should be the SH? Not a good idea to own FAs through an individual SH bc when you pay dividends back they are taxable right away. Holdco can receive dividends and get s. 113 dividend deduction.

B. UNLIMITED LIABILITY CORPORATIONS (Slides)**

ABCA, s. 1(kk), 1.1, 15.1-15.9, 46(1), 173(1)(a) & (m.1)
FCIT, p. 1363-1367

2: CRA sees a ULC just like any other corporation.

3: England introduced ULCs in 1800s and Ireland allows them.

4: US does not have concept of integration so try avoid corporate tax. S-Corp a flow through corporation or unlimited corps and partnerships.

5: Flow-through – partnership or disregarded altogether. Basic rule: All Cdn corporations are treated as corporations for US tax purposes **per se**.

6: Exception to general rule. NS had monopoly for 15 yrs. Thus, if this type of entity, not a per se corporation.

7: Eligible entity has a choice.

8: Cdn ULC is an eligible entity. If no election, default is a partnership if more than one owner and a disregarded entity if single owner.

9: Hansard debates from AB legislative assembly. None of these are correct. ULCs are TPs and if PE in AB, will pay corporate tax in AB. The bottom point is true, but only for US, not Cdn TPs. *ULC is a US tax planning tool, not a Cdn tax tool.

10: 11:

12: Ont. and BC are studying the concept.

13, 14: 15: 16: 17: 18: For comparison – provisions for limited liability corporations.

19: 20: 21: “unlimited in extent” – straightforward. “joint and several in nature”:

Joint: if contract, both people can promise to pay C \$100. C will get either \$100 from A or B. If A pays \$100, A can go after B. C can sue both, but huge procedural hurdles.

Several: Separate promises. Thus, C can collect \$100 of each so \$200, but A and B have no relationship.

Joint and several: combine both but not cumulative (only \$100) and can sue both without procedural hurdles.

Not defined in leg'n so ordinary CL rules apply.

22: Leg'n by oversight does not say joint and several with whom. Thinks SHs are joint and severally liable with each other and not likely a single SH would be joint and severally liable with ULC.

23: 4 ways. 24: Must use phrase exactly. 25: 26: Not on-line! Dumb. 27:

28: Serious flaw! SH “prior”: doesn’t say immediately prior. In prof’s view, could be a SH 5 or 10 yrs ago. Past SH cannot no control over amendment to an ABULC. 29:
30: Same 2 key components.
31: Here, liability is clear: only the SHs of “the amalgamated ABULC”.
32: Remember the laws wrt continuance must be complied within both jurisdictions.
33: Liability not an issue here: clearly past SHs not liable.
34: NSULC or Ireland. Problem with drafting bc two types of liability between an ABULC and NSULC. NS Registrar has not permitted continuation of ABULCs into NS bc argued that SHs of an NSULC would be prejudiced if continue into ABULC, so a moot point now.
35: 4 ways: amalgamation requires Ct consent. Typically, unless know right away, use the last one (plan of arrangement), not the middle two.
36: If AB, can continue in as an ABULC in one swoop.
37: Not on slide: Even if corporation fails to put it on share certificate, the SHs are still liable.
38: Need not tell the world who the SHs are on incorporation. But on annual return, you must list all the voting shares, but not the non-voting SHs. 5 boxes only; so if more, only have to put the top 5 in voting shares. 15.8 for creditors to see who are the SHs. Who is a “listed SH”? Guy told him those listed on the annual return. But Registrar can go to anyone of the 5 listed to disclose all the names and addresses of the other SHs. Creditor needs to get support from Registrar.
39: Can go the other way: Ensure in new articles get rid of ULC in name and remove express statement of liability (all you really need to do).
40: Would need permission of NS Registrar.
41: Same as normal dissolutions, but with limited corporations, only liable for ppty they received on dissolution.
42: The kicker: “including the past SH” responsible for the full amount. DS: This is the most troublesome of all the legislative provisions. Likely any presumption of retroactivity would be rebutted by the express language.
43: DS recommends an empty shell corporation in the US between the wealthy corp and the ABULC.
44: NSULC liability different. Leg’n refers to them as “members” not “SHs” but basically the same. A member of the NSULC has no direct liability to the C. Nothing happens until the NSULC is wound up (maybe Cs could cause the corporation to be wound up). Exposure of former member only lasts for one year; after one year, no exposure. If current members have the assets, the Ct may relieve the former members.
45: NSULC attractive. 46: Fees like any other AB corporation.
47: NS got greedy. At least they expressly call it a tax via the statute.
48: Corporate incest rule in AB: a subsidiary cannot hold shares of its parents. Only applies to voting shares.
49: 50: Tax planning idea: Good: Seller wants to sell shares and buyer wants to acquire assets. Problem: It states anyone who was a past SH is liable to the obligations. Exposure to the vendors, no exposure for purchaser.
51: Another planning point: good if losses. 52: Also good if making money.
53: Related articles. There are a few more articles out there as well. DS paper available on the CTF website.

Next class: Get through FA and only briefly on NR trusts (won't delve into bc complicated and new amendments coming up). Misuse – not much time. International tax planning – a little work under C. Only a bit on business reorganization (A). Did B (ABULC). Talk about general concepts of transfer pricing – will put case called Irving Oil where TP that led to many of the ITA changes. May not do last topic. Might cut a couple topics short.

C. FINANCING

1. Thin Capitalization Rule

ITA, 18(4)-(6)

Specialty Manufacturing [1999] FCA

FCIT, p. 1367-1374

18(4) to (6) provide the “thin capitalization” rules. They limit the debt/equity ratio for Cdn subs of NRs to 2:1 [\$67/\$33] (formally 3:1) by limiting the deductibility under 20(1)(c) of interest paid to NR SHs. 18(4) provides that where sub corp's debt to related party NRs results in a debt to equity ratio in excess of 2:1, any interest on the excess portion of the loan over the maximum approved proportion is automatically disallowed for tax purposes. In effect, this forces a NR setting up a Cdn sub to provide 1/3 of financing through equity rather than only using debt (e.g. if sub needs \$1 million to build factory in Canada). **Purpose: Uddeholm** (quoted in **Specialty Manu**) Cdn sub deducts. Parents pays withholding tax but has withholding tax if dividends. If parent in lower tax jurisdiction than Canada, foreign investors would essentially shift income outside Canada to tax there (bc get deduction in Canada).

*Rules only apply when NR has Cdn sub (only corp).

*Rules only apply to SH who owns at least 25% of Cdn corp (either alone or with persons at NAL – voting or FMV, or options to buy shares of corp) “**specified shareholder**” (can trick us). If NR owns 10% of CanCo, can borrow from NR and need not worry about thin cap rules.

VK: CRA is of the view that the thin capitalization views do not violate the non-discrimination clauses in Canada's treaties. **18(6)**: Prevents taxpayers from avoiding the thin capitalization by funnelling loans through third parties.

Specialty Manufacturing [1999] FCA

F: Husband and wife in US decided to come to Vancouver. Set up S Ltd. (Cdn corp) to buy and sell souvenirs. Did well. First yr, \$67K equity. Then took out RE (paid dividend). Had \$100 share capital (equity). Lent \$10 million from various related US corporations to S Ltd. D/E ratio: \$10 million: \$100, so \$100,000: \$1. D: Disallowed majority of interest (met all the req'ts).

VK: Other factors to financing: availability of capital, cost of financing in host and home countries, foreign exchange risk and restrictions, debt-equity capital ratios and anticipated cash flow from business operations to pay for borrowed capital.

VK: Once determine want operation in Canada through Cdn sub, must consider whether should use debt or equity (tax and business considerations). Part XIII imposes withholding tax on payments of investment income to NRs. Some exceptions though.

Advances of financing Cdn business through debt capital:

- Interest expense on debt is deductible if use for purpose of earning income from a business provided amt is reasonable and not incurred in pursuit of exempt income [20(1)(c)] (under Part I). In contrast, dividends on share capital are paid out of after-tax dollars.
- Although interest paid to NR person by Cdn resident subject to 25% withholding tax at source, there are extensive exemptions from the tax. VK says debt financing can even be set up to avoid the withholding tax – no detail – 212(1)(b).
- NR can borrow either in a foreign currency or Cdn dollars without foreign exchange controls. Foreign exchange gains or losses will give rise to either income or capital depending on the circumstances.

VK: But dividend income may be subject to lower rate via treaty (check) than interest.

***The ultimate structure should depend upon the consolidated effect on both the parent and sub corporations.

A foreign corporation can use debt to finance its Cdn operations in several ways. It can borrow and then:

- Lend money to its Cdn sub
- Invest in equity of its Cdn sub, or
- Allocate interest to its Cdn branch operations

Each has different tax consequences.

2. Indebtedness Owed by NRs

ITA, s. 17(1)-(3), (8)

Massey-Ferguson [1977] FCA

Canadian Occidental U.S. Petroleum Corp. [2000] TCC

Outbound situation: Cdn resident (Canco) who owns 100% and lends money to NR (Forco). What if investment free loan? Would shift money from Canada offshore.

Basic Rule: To preclude a Cdn corporation to borrow money interest-free or a low rate of interest to a NR. Only applies to loans to NR and only applies to loans by corporations. If don't charge market rate of interest, Cdn lender deemed to receive interest on that.

S. 17(1): 3 conditions to apply: **1.** Where a NR person owes an amount to a Cdn resident corporation. Need not have a formal loan. E.g. Promissory note satisfies.

2. Outstanding amount must be owing for more than a year.

3. Interest Cdn corp actually received (i.e. low interest loan) plus FAPI component (if any) attributed from NR back to Cdn corporation. If this amt is less than indebtedness computed at a reasonable rate, meet section. If spread, take prescribed rate of interest and

multiply amount owing. That amount less actual interest is amt included. Reg 4300: 3% is prescribed amt. If use prescribed rate, probably okay.

17(2)–17(6): Anti-avoidance rules: Won't deal with. Indirect loans. E.g. Cdn corp lends money to ind who lends to NR.

Important exception: 17(8): Need to lend to a controlled foreign affiliate throughout the period of time which amt is owing. Parentco owns 100% of Canco1 and 100% of Canco2. Canco1 owns 1% of Forco and Canco2 owns 99% of Forco. To be FA, Cdn entity must have an equity % of at least 1% and then at least 10% owned by the same corporation or related corporation. Yes, Forco is a FA of Canco1. Also a CFA of Canco1 (can look to control by related parties). Even control if 4 or fewer Cdns. Restrict: Forco required to use money in course of carrying on an active business, or has to use the money to earn active business income while loan outstanding.

Massey-Ferguson [1977] FCA

F: MF Ltd. (Canada – the taxpayer) owned 100% of V Ltd. (Canada) owned 100% of NR (USCo). MR loaned to V who loaned to NR. Documents: MR to V to NR (only acting entries, not any legal loan contracts). Flow of cash: Straight from MR to NR (bc V did not have a bank account, nor any EEs). *Should have had loan contracts and open up bank account for V (so wouldn't even have issue). ME: CRA argued interest-free loan from MF to USCo and exception did not apply (not a subsidiary controlled corporation). NR used the money for active business.

D: Taxpayer won. Ct nice to parties. Intent and understanding of parties was that it was a two-step loan, to create a creditor-debtor relationship between V and NR. DS: Sham still relevant, but normally use GAAR.

Canadian Occidental U.S. Petroleum Corp. [2000] TCC

F: CanCo1 owned 100% of CanCo2 (TP) owned USCo. Canco2 made interest-free loan to USCo (\$ used in its business). Then Canco1 transferred Canco2 shares to sister company, Canco3 (sub of Canco1).

D: TP won. Nothing in wording in leg'n that TP had to maintain direct ownership or control over whole period. Ct: No justification (not ambiguous) existed Ct to add words "and throughout period in which loan was outstanding, borrower continued to be subsidiary controlled corporation". [words clear: if a loan was made to a ...] ***Now, rule changed. Throughout period, must maintain CFA status and borrower must use money in active business. ME: Subsequent leg'n (current leg'n) could not be used to interpret the provisions in this case.

DS: Massey and Cdn Occidental have provision not in ITA today so not directly applicable, but good examples of planning techniques and issues. Massey: good idea to show money trail.

XI. TRANSFER PRICING

ITA, s. 247(1)-(4)

Can-US Treaty, Article IX

Irving Oil [1991] FCA

FCIT, p. 1353

Countries looking for ways to shift income outside Canada. OECD Principle: When related parties transact with one another across an international border, for tax purposes they should be treated as though they act the same way as unrelated or arm's length parties interact. For economic purposes, can do what they want. But for tax – must be arm's length price.

OECD definition of tracing pricing: The determination for tax purposes (not real economic purposes) of prices charged or paid on the transfer of physical goods or intangible ppty or paid on the supply of services between associated enterprises in different tax jurisdictions. “Associated” here means related or NAL (not like our ITA). “Enterprise” any type of business organization (corp, trust, partnership, whatever).

Irving Oil [1991] FCA

F: IO Ltd. (Canada). Oil produced in Middle East. SOCAL sold oil to IO Ltd. SOCAL actually owned about 50% of IO Ltd. Cost SOCAL \$2.24 to produce. Wanted to ensure transportation aspect not in Canada. BermudaCo wholly owned by IO Ltd, but remember SOCAL owns about 50% of IO Ltd. Then BermudaCo bought at \$2.24 and sold it to IO Ltd. at \$2.90.

Don't focus on legal argument. Old s. 245: not GAAR. Ct acknowledged \$0.66 attributable to cost of transportation. D: Thus, IO Ltd. could prove they paid FMV to BermudaCo. In other words, paid what arm's length parties would have paid. CRA: Should only have to pay \$2.44. Ct: Nothing artificial if pay FMV.

*Remember BermudaCo really did nothing (mere paper routing).

Current Transfer Pricing Rules: Canada changed its transfer pricing rules in 1997 to (1) Harmonize our req'ts with OECD standards; (2) Require TPs to retain current and contemporaneous documentation. **247(1): Highlights:** **1.** Define “transfer price” is simply the price at which parties transaction. **2.** Define “arm's length transfer price” price unrelated or arm's length parties would have in a contract (FMV). **3.** “document due date” day a TP has to file his or her tax return for particular year. **4. 247(2):** When related parties transacting across borders, they must put price the same as unrelated or arm's length parties would. If don't, CRA can tax as if an unrelated or arm's price was paid. **5. 247(3):** Penalty: CRA will tally up adjustments. Penalty if adjustments exceeds lessor of two amounts: (1) 10% of TP's gross revenue; (2) \$5 million. Tf, not going after small fish. Penalty: 10% of all those adjustments. **6. 247(3):** Can avoid penalty if TP makes reasonable efforts to determine arm's length transfer prices and actually use those

prices. **7. 247(4)**: TP is deemed not to have made reasonable efforts to determine and use arm's length transfer prices, unless TP makes or obtains contemporaneous documentation (can also go and get it). E.g. Price of oil at X date. Contemporaneous documentation or prepared before document due date. E.g. Corp with Dec 31 YE; to determine 2005 prices, must compile documents by June 30/06. If CRA requests documents, must send in 3 months.

DS: Irving Oil would be decided same way. Price was same as a NAL price. If can prove you are correct, need not have contemporaneous documents (bc deals with penalties).

XII. METHODS TO COUNTER INTERNATIONAL TAX EVASION

ITA, s. 163(1)-(2), 238(1), 239(1)
FCIT, p. 996-997

One way is to have more enforcement (resources).

163(1): Penalty for people who fail to report income. **163(2)**: Penalty on TPs who make false statements or omissions on returns.

238(1) and 239(1): Create offences for failing to file a return or making false or deceptive statement on return. Key point: Must apply criminal principles (actus reus and mens rea; burden of proof on Crown to prove beyond a RD). VK: Revenue rule: one country will not enforce tax laws of another country. Sometimes bilateral treaties have exchange of info provisions. Getting closer to overriding rule. VK: Tax planning, avoidance, and evasion all different things.

Foreign Reporting Rules: 233.1-233.7: Highlights:

- 1. 233.1(2)**: If person in Canada entering a transaction with NR, person in Canada ("reporting person") must file with CRA an information return explaining transaction.
- Only apply where parties are NAL. If arm's length, no reporting.
- 3. 233.1(4)**: Reporting requirement does not apply to transactions whose value is \$1 million or less.
- 4. 233.2(4)**: When a Cdn resident transfers or loans ppty to a NR trust (with Cdn beneficiary), then could be reporting req'ts.
- 5. 233.3(3)**: Cdn resident who owns specified foreign ppty with an aggregate cost of greater than \$100K, must file an information return (box on T1). E.g. Condo in Florida.
- 6. 233.4(4)**: If Cdn resident has FA, then Cdn resident must file a return saying so.
- 7. 233.6(1)**: If NR trust and person in Canada receives a distribution from trust, person in Canada is required to file an information return (even if not taxable).

EXAM

Saturday, Dec. 17. 9:00 a.m. 2 hours long + 10 minutes reading time. Finish 11:10. Room 113 (this room). Open book. Final: Worth 90 marks. Won't be a single question. Between

4 to 7 questions. Specific marks per question. Variety of styles to questions. At least one traditional law school fact pattern (hypo with facts, find issues, advise a client, or write a brief for a Ct – must spot the issues). One or more explain type short answer questions. Explain the objectives of the transfer pricing rules. These will be easy, providing you can find it in your materials. Thus, won't give too easy.

Written component: Approach exam as an opportunity to show him what you know (get extra marks). Must show statutory references. If number, assumes Act. If Treaty or Regulation, make that clear. BUT don't take time to quote that particular section. Citation and quick indication of what it says. If applicable cases, put it down. Main thing: He is focusing on the principle of the case. Most cases in the notes. If can't remember case name, just put down a certain fact. Don't restate facts. Not relevant to exam. If particular fact is relevant, then mention. But don't mention whole set of facts.

Recommend with hypothetical problem: (1) Identify issue; (2) Explain the law; (3) Apply law to facts; (4) Reach conclusion. See his corporate exam marking matrix to see how he approaches marking. First is identify issue. Detail gets the marks. HE won't give the syllabus. We must bring it in. He'll e-mail a final copy of the syllabus in the next week or two.

If questions, e-mail. One question per e-mail. Send specific, narrow questions. Try answer and, if can't, then e-mail him.

Not on exam: NRTs and FIAs NOT on the exam.

Lightly examinable (basic, elementary type question): FAs and FAPIs. Is there a FA? Is there a CFA?

Tends to like to examine on areas with case law (not just straight legislation). See how approached material in class.

Doesn't care about what conclusion you reach. Doesn't care of answer whether a certain decision was decided correctly.

Could ask: Apply the current law to the fact pattern.