Residence Taxation: capital export neutrality

Source taxation: capital import neutrality

OECD Model: used to interpret actual local treaties

UN Model: more jurisdiction to source countries, used more by developing countries;

Reasons/Goals for having tax treaties

* Avoidance of double taxation (most important)
* Prevention on fiscal(tax) evasion and tax avoidance
* Administrative cooperation
* Non-discrimination (on the basis of nationality, residence allowed)
	+ Canada does discriminate through “branch tax”
* Avoid double taxation
	+ Resident/resident conflict; Resident/Source conflict; Source/Source conflict;

## Interpretation of Tax Treaties

### Source of Interpretation

* Text of the actual treaties
* Domestic Law (legislature and case law)
* OECD Model, UN Model and their Commentaries
* Government issued comments: technical explanations;
* Foreign jurisprudence; Expert; tax literature

### Principles of Interpretation - The Vienna Convention

*Art 31: 1*. A Treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose; *2*. Context include text (w/ preamble and annexes) and (a) agreement relating to the treaty made b/w all parties in connection with the conclusion of the treaty; (b) any instrument which was made by one or more parties in connection with conclusion of treaty and accepted by other parties; *3*. Take into account (a) subsequent agreement (b) subsequent practice in application and (c) relevant rules of international law applicable; 4. Special meaning shall be given to a term if established that parties so intended

* **Edwards v The Queen** – Can-China Treaty does not apply to HKSAR, according to the purpose, subsequent agreements and practices of the contracting states; Court: ***commonly expressed intention*** of parties entitled to great weight & shouldn’t be ignored unless contrary intent can be shown in words of Treaty or other expression by parties
* **Crown Forest Case**
	+ Fact: CF rents from Norsk (incorporated in the Bahamas); Withholding tax of 25% would be reduced to 10% under Can-US Treaty; Issue was whether Norsk is resident of US;
	+ Court used purpose approach with the aid of extrinsic materials and decided it was not intended for corporations like Norsk to benefit from the treaty
	+ Object and purpose =not just intentions, but also goals, such as prevention of double-taxation and evasion

*Art 32* *Supplementary means of interpretation (for finding object and goals)* may be used, including preparatory work and circumstances of its conclusion to confirm 31, or when *31 (1) leaves meaning ambiguous or obscure*, or (b) leads to result manifestly absurd or unreasonable

* Sometimes the absence of sth compared to Model Convention also speaks of intent
* **Gladden Estate** – Treaty: sale or exchange of capital assets exempt from tax; ITA: deemed disposition at death;
	+ FCA: manifestly absurd or unreasonable if deemed disposition not exempt

### Definitions and Undefined Terms

***OECD*** *Art 3(2)* – Any term not defined shall, unless context otherwise requires, have the meaning it has at that time under the law of that State for purposes of the taxes to which Convention applies, any meaning under applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

* Canada-US Treaty Art III: similar with addition “or competent authority agree to a common meaning pursuant Art 25”
* Canada-UK Treaty Art 3 also similar;

***Income Tax Conventions Interpretations Act***

* *3* Terms (a) not defined, (b) not fully define or (c) to be defined by reference to Canadian laws, has the meaning of the ITA, as amended from time to time, not its meaning when treaty is entered if ITA changed

# Residence Taxation

Implications for Being a Residence of a Country

* Subject to tax on worldwide income – fullest possible taxation; but also comes with credits; Non-resident person only subject to income from sources inside Canada;
	+ *2(1) every person resident in Canada at any time in the year; 3(a) source inside or outside of Canada; 2(3) tax payable by non-resident persons, income earned in Canada (source) when employed in Canada, or carry biz in Canada or dispose of taxable Canadian properties*
* Part XIII withholding tax only apply to non-residence
* Residency gives access to treaties

## Individual Residence

### Domestic Rules

#### Factual Residence – 250(3) Ordinarily resident

Common Law: Residence is a matter of the degree to which a person’s 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

* *Significance Residential Ties*: dwelling place(s); spouse or common-law partner; dependents
* *Secondary RT*: looked collectively: personal property, social and economic ties, landed immigrant status or work permit; insurance coverage; diver’s license; registered vehicle; seasonal dwelling; Canadian passport; union or professional organization membership;
* *Other RT*: limited importance but can be taken together with other RT: mailing address; post office box; personal stationery like biz cards; phone listing; newspaper/magazine subscriptions

***Date Non-Resident Status Acquired***: when all RT severed, exception: date left for person originally non-resident of Canada

* **Schujahn**: US citizen moving back to US acquire non-R when he left, despite visiting spouse/kids still in Canada
* **Griffiths**: Canadian citizen acquired non-R despite still official marriage to wife – no “legal separation” in Canada

***Application of Term “Ordinarily Resident” when leaving Canada***

Important when individual didn’t sever all RT, but physically absent for considerable period of time

* Evidence of intention to permanently sever RT with Canada – question of facts, case by case
	+ Into account: length; foreseen return; comply with tax for leaving Canada; inform for withholding tax purpose
	+ CRA: intention to return not necessarily lead to residency in Canada
		- *Beament*: solider found not to ordinarily resident despite intention or hope to return;
* Regularity and length of visits to Canada;
* Residential ties outside of Canada;

**Thomson v MNR, 1946**

Fact: original resident of Canada left for US; Later built a vacation home back in Canada and stayed for less than 185 days/yr.

Court: TP “ordinarily resident”(2 residents), not sojourning: place where in the settled routine of his life he regularly, normally and customarily lives; Result would differ if he weren’t originally a Canadian resident; result would change today due to treaty

*Hauser*: pilot “ordinarily resident” of Canada; never divorced Canada: 1/3 time spent in Canada, regularly stayed at in-laws, joint account; despite cancelling apartment and renting one in Bahamas, plus shipping his car and boat there;

*Filipek*: onus on TP to demolish Crown’s assumptions; He failed to do so by lying about staying in a tent;

*Laurin*: pilot successfully acquired Non-R: divorce and without home available to him; no investment in Canada

*Reeder*: 8 months in France and stored belongings: court: highly mobile stage in life; Ordinarily resident in Canada;

Ferguson:

***Factual Residence for Entering Canada***

Similar to leaving; Date is when entering Canada;

Dwelling Place usually RT unless leased to arm’s length, or when never lived there

#### Deemed Residents – 250(1)

Note: deemed residents does not apply to factual residents (can’t be both), apply to whole year (differ from factual), and does not apply for provincial purposes;

* Whole year exception: when deeming based on some official position like ambassador or solider, 250(2) deeming only for part of year until position ceases, same with spouse and children

**250(1)(a) Sojourners** – individual no sufficient RT but sojourned (not commute) 183 days or more deemed for whole year

* *Elliott, 2013* – not factual, deemed residents for sojourning; US citizen came for job, stayed in hotel, minimal furniture;
* Note a distinction b/t middle-aged professional and college students: latter much less connections
* Went for tie-breaker rule and the US won;
* *R & L Food Distributors*: commuters are not sojourning, you have to stay for the night;
* *Zimmer*: any sojourning ends when one becomes factually resident

#### Deemed Non-Residents – 250(5)

250(5): A person deemed non-resident if he would be resident under ITA but is resident in another country and not Canada under a tax treaty – see “Treaty Rules” under

#### Part-Time Residents

**114**: tax on worldwide income for part of year TP is residence, and on source income for part of year TP isn’t – Grant?

**118.91**: similar provision on the deduction side

### Treaty Rules

#### Tie-Breaker Rules

(1) Permanent home; (2) Centre of Vital Interest; (3) Habitual Abode; (4) Citizenship; (5) Mutual Agreement

OCED Model Art 4 & Can-UK Treaty Art 4: First (1); If both, (2): If neither, (3); If (3) both or neither, (4), then (5)

Canada-US Treaty Art 4: (1), then (2), then (3), (4), (5);

**(1) Permanent Home**

**Salt Case** – TP born and raised in UK, moved all over the place, ultimately in Canada; Worked for 2 years in Australia

* Court: no doubt is resident of Australia; whether under domestic law whether also resident in CAN court has reserves
* Tie-Breaker solves it: no PH in Canada, arm’s length lease broke PH connection, given it’s 6 month;
* PH: “individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evidence that stay is intended to be of short duration:
* CRA: PH available if a dwelling maintained in a condition suitable for year-round occupation, leased to NAL party, or leased under agreement that can be broken with 3-month notice or less;

Wolf, 2001 – US citizen in Canada, rent out apartment in US for 1-month notice: PH available in US as well as Canada

* Note Canada trying to get source income, since under treaty exempt unless with permanent establishment; offer loses on tie-breaker rules

Minin, 2008 – Russian general mom living w/ divorced wife – PH was available

**(b) Centre of Vital Interest**

*OECD Art 4 Commentary* para 15: if PH in both, look at the facts to ascertain where personal and economic relations are closer; Regard will be had to family and social relations, occupation, political, cultural or other activities, place of business, place from which he administers his property, etc. Considerations based on personal acts of the individual must receive special attention; Treaty version of gravitation pull;

**Gaudreau, 2005** – TP and wife went to Egypt; Tie-Breaker: PH in both countries;

* COVT remains in Canada: did not have a social life in Egypt and did not establish new relations;

*Gravitation Pull*

* *Hertel, 1993*: the depth of roots the roots for COVI more important than their number
* *Yoon, 2005*: TP maintained ties in South Korean & spent most days there; PH both, COVT in Korea; Intention to retire in Canada does not affect where COVI is
* *Wolf, 2001:* US citizen doing consulting work in Canada; Resident of US on COVI tie-breaker; all ties US;
* *Trieste, 2012:* Court could not decide on COVT: US citizen lived in Canada, visited US every month;
	+ *Duff:* wrong for court to say not clear just b/c he didn’t purchase his US house before coming to Canada

**(c) Habitual Abode**

**OECD Art 4 Commentary – poorly worded, seemed to emphasis on time/frequency of stay**

Para 17: Where PH in both, go to COVT, but in that case having a *habitual abode in one rather than the other* appears therefore as the circumstance which, in case of doubt for COVT, tips the balance towards the state where he stays more frequent;

Para 18: Where PH in neither, go to habitual abode straight;

Para 19: Comparison must cover sufficient length of time to be possible to determine whether residence is a habitual abode

**Lingle, 2010** – US citizen as contractor in Canada, spent most time here; Agreed resident in both for domestic tax purposes

* Analysis: PH in both; COVT too difficult to determine; Agreed habitual abode in Canada;
* Issue he also has habitual abode in US; If so, citizenship US wins out, no source tax and no resident tax for Canada;

Court: not a frequency test asking where stayed more frequent – Decision is no HB in the US

* Habitual: regularity and continuity; Abode: reside; so “where he lived regularly, customarily or usually”
* “It must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular state

Change of Residence

## Residence for Corporations, Trusts and Partnerships

When it comes to residence

* Usually place of management; US: solely place of incorporation; Canada uses both
* And review Crown Forest case on resident issue

ITA: Taxpayer includes any “person”, which could be individuals or corporations and trust which is taxed like a person, but not partnerships.

### Residence of a Corporation

Common Law: Place of ***central management and control*** – usually where Board of Directors meet, with elective element

* *De Beers* - Residential Ties of Corporate “Persons” similar to individuals: it can keep house and do biz;
* *Bullock* – place of residence for person who effectively controls the board’s decisions deemed place of resident for cor
* *Wood v Holden* – rubber stamping tax scheme worked; Threshold for establishing central M &C pretty low;
* *BC Electric Railway* – Central M&C in Canada: directors and officers residents of Canada; all biz in Canada except formal administrative biz required at registered office in England

#### Statutory Place of Residence

* *250(4) Deeming Rule:* (a) Corporation deemed resident of Canada if incorporated in Canada after April 27, 1965
	+ If incorporated in Canada after that, still deemed so central management and control or carries on biz in Can
* 250(5) Deemed non-resident if would be resident but tie-breaker says resident of another country
* *250(5.1) Exception for continued Corp* A continued corporation, from time of continuation, deemed to be incorporated in jurisdiction of continuance – Corp incorporated in Canada, once continued elsewhere, deemed non-resident of CAN
* *250(6) Exception for International Shipping Companies*: deemed resident of incorporation country, even if central management and control in CAN; So only subject to Canadian source income
* *Note*: resident usually determined by place of management; US solely on place of incorporation; Canada both;

#### Treaty Test: Place of Effective Management - OECD

* *Art 4(1)*: Resident means any person who under laws of that State is liable to tax by reason of domicile, residence, place of management or similar criterion.
* *Art 4(3):* For 4(1), if person other than an individual is resident of both, deemed resident only of State where Place of effective management lies – tiebreaker rule of corporations

Can-US, and UK Treaty

### Residence of a Trust

Trust: a relationship where trustee has legal control over property on behalf of the beneficiaries;

* There is no deeming rules for trust???

#### Statute – ITA

* 94: deems an otherwise non-resident trust to be one in respect of the passive income and Canadian source income earned by the trust
* 104 (1): reference to trust include reference to trustee, executor, etc;

***Thibodeau Family Trust, 1978***

Fact: Trustees lawyers in Bermuda, all assets and admin stuff went to Bermuda; Mr. T had power to appoint more trustees, but decisions made by majority of trustees; Occasionally T treated it as his own without consulting other trustees; pre-capital gain

Issue: Tax authority says Trust resident of Canada – T wins, Up to Garron, as long as trustee in that jurisdiction, scheme works

Court: Trust can never have dual-residence; therefore not the same test for residence of a corporation;

***Garron Family Trust, 2011***

Residence of a trust is a fact-driven analysis to determine place of central management and control

* Line to be drawn: beneficiaries making strong recommendations or really excising power & discretion (case here)

### Residence of a Partnership

Partnerships not “persons” for the purpose of the ITA, and are “flow-through” entities - Complexities with hybrid entitles

#### Statute – ITA

* *96*: income earned through a partnership is taxed to the partners
* *212(13.1) Deeming rule for the purpose of Part XIII withholding tax:* partnership deemed resident person if it pays amount to non-resident investors, or a non-resident person if it receives payments from Canada;

# International Tax Avoidance

## Treaty Shopping

When a person acts through a legal entity created in a state to obtain treaty benefits that would not be available directly

* Inbound Treaty Shopping: funnel money through conduit state to access treaty benefits – MIL, Crown Forest
* Outbound Treaty Shopping: artificially turns Canada into a source country – Antle

Responses to Treaty Shopping

* Residence; beneficial ownership; inherent anti-abuse principles???

### Tax Treaty Anti-Avoidance Rules

#### Beneficial Ownership for reduced treaty rates on dividends, interests and royalties

**Prevost Car**

Fact: PC owned 100% by PHBV, which is owned 51% by Volvo and 49% by Hanly; SH agreement: profits of PC and PHBV distributed up to 80% to V & H; PC and PHBV shared some directors, would pay dividends w/o SH approval sometimes;

Issue: Who is the BE? V & H from UK & Sweden, 10% withholding tax; PHBV Netherland, 5%;

Court: BE – unfettered right to use & enjoyment of income; assumes risk and control of dividend received***;***

* Conduit: must have ZERO discretion on distribution of dividend, even legally; court won’t piece corporate veil otherwise – in this case PHBV itself not party to agreement, so V&H can’t legally force it to follow dividend policy

**Velcro Canada**

Fact: VCI pay royalties under license agreement to VIBV, which changed corporation to N. Antilles; To utilize treaty with the Netherlands, VIBV incorporated VHBV in Netherlands and reassigned the license to it; VCI then pay royalties to VHBV;

Analysis: ownership of intellectual property remained with VIBV, which is specified as third party beneficiary with right to enforce licensor’s rights if VHBV failed to do so; VHBC agreed to pay VIBV AL % of net sales w/i 30 days of payment from VCI;

Court – VHBV is BO, find for TP

* **Beneficial ownership** from Prevost: consider ***possession, use, risk and control***
	+ *Despite contractual obligation to make payments, no automatic flow of funds. Intermingled not segregated; VHBC had sole discretion to use them, provided they come up with the right amount in 30 days from wherever;*
* **Agency**: must have ability to affect the legal position – not the case here
* **Conduit**: must have absolutely NO discretion – not the case here

**Purpose Tests – Canada-UK Treaty**

**10(7) Dividends**

This Article does not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment.

* Article 10: beneficial ownership reduced withholding tax rate

11(11) Interest

The provision of this Article does not apply if it was the main purpose or one of the ain purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment

12(8) Royalties

Article does not apply if main purpose or one of the main purposes…

***Canada-US Art XXIX A – Limitation of Benefits***

1. Benefits of the treaty limited to qualifying persons, or exceptions under para 3, 4, and 5.

**2. A Qualifying person is** a resident of US or Canada that is

* (a) a natural person; (b) government agency; (c) publicly traded entity; (d) subsidiary of publicly traded entity; (e) entity with appropriate ownership and absence of base-erosion arrangements; (f) estate; (g) charity of other nonprofit; (h) exempt pension or similar plan; (i) exempt organization with (g) or (h) as beneficiaries
* (c) a company or trust whose principle class of shares or units (and any other disproportionate class of shares or unites) is primarily and regularly traded on a recognized stock exchange
	+ *Definition 5:*
		- *Principle class of shares: ordinary or common shares representing majority voting value & value of company. Or classes in aggregate*
		- *Primarily/regularly: US technical expl’n: P=more than others; R=at least 60 days and 10% of shares*
		- *Disproportionate interest: any class of shares of company resident in one state entitling SH to disproportionately higher participation, through dividends, redemption payments, or otherwise, in earnings generate in the other State by particular assets or activities*
		- *Primary place of management and control: where executive officers & senior management employees exercise D-to-D responsibility for the strategic, financial and operational policy DM, & staff conduct D-to-D activities necessary for preparing and asking those decisions – which ever State these happen more*
* (d) a company more than 50% of the vote and value of shares (other than debt substitute shares) of which is owned, directly or indirectly, by 5 or fewer persons each of which is a company or trust in (c), provided that each company or trainst in the chain of ownership is a QP
* (e) base erosion test: if company or trust owned at least 50% (vote & value other than debt substitute) by qualifying persons and deductible on payments to non-qualifying persons less than 50% of gross income;
* (f) estate
* (g) non-profit organization, provided that more than half of the members are qualifying persons
* (h) trusts that benefit qualifying persons

**Exceptions**

3. A resident but non-QP of Canada derives income from US in connection with or incidental to **active conduct of trade or business** in Canada, gets treaty benefits, if such trade of business in Canada substantial in relation to activities in US

4. **Derivative benefits test** - A company resident of Canada shall be entitled to benefits of dividends, interests and royalties if

* (a) shares representing more than 90% of vote and value, owned directly or indirectly by QP, citizen/r of US, who
	+ (i) resident of a country with which US has a tax treaty and entitled to its benefits, and
	+ (ii) would qualify for benefits under 2 and 3 if person were a resident of Canada, and
	+ (iii) would be entitled to rate of US tax between country of residence and US at least as low as rate in treaty
* (b) and, deduction on payment to non-QP less than 50% of gross income
	+ QP could be resident of third country:

6. Can grant benefits if competent authority so decides;

7. GAAR applies: This does not restrict right to deny benefits where reasonably result in abuse of provisions

### Inherent Anti-Avoidance Rules

**MIL Investments, 2007**

Fact: Boulle owns parts of MIL, which owns DFR; MIL transferred DFR shares so its ownership under 10%; MIL then continued in Luxembourg from Caymans; Key personnel death; MIL sold DFR, capital gain exemption under treaty with Luxembourg since ownership under 10%

***Inherent Anti-Avoidance Rules***

* Vienna Convention Art 26: Pacta sunt servanda: treaty must be performed in good faith; Art 31; good faith…
* OECD 2003 Commentary: purpose of tax treaties include prevention of tax avoidance

Court: Treaty did not preserve or make reference to domestic anti-abuse rules

* Only consult OECD commentary in existence at the time Treaty negotiated without reference to subsequent revisions – qualified in Prevost Cars;

**GAAR – 245**

* Where a transaction is an avoidance transaction, the tax consequences shall be determined as is reasonable in the circumstances in order to deny a tax benefit that but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.
	+ Tax benefit;
	+ Avoidance (series of) transaction – primary purpose to obtain tax benefit, not bone fide purpose
	+ Misuse/Abuse – tax benefit not reasonably consistent w/ object, spirit or purpose of provisions relied upon
		- (a) determine purpose of provisions conferring tax benefit; (b) see if purpose frustrated

*Application to MIL*

* Tax benefit – exemption and deferral;
* Avoidance transaction or series of T – primarily for bone fide purposes
	+ Reason for sale to realize gain; ensuring it’s tax effective is a “how” that’s subordinate to the “why” of sale
	+ Not Preordained: he could not have controlled all the other SH into arranging the ultimate sale
	+ Not contemplated that the key personnel would die
* Misuse/Abuse – not necessary, and not anyways
	+ These exemptions not on OECD, presumably Canada aware of possible use like this;
	+ TP’s reliance upon a Treaty provision as agreed upon by countries cannot be viewed as being a isuse or abuse

**Antle, 2010**

Fact: capital property step-up: husband transfer property to offshore trust with wife as beneficiary, who purchase it from trust at FMV, triggering capital gain not taxed; then wife sell to 3rd party to payoff price owing to trust; Trust then distribute fund to beneficiary wife and dissolves;

* 73(1)(c) rollover on spousal trust; 95(1)(c)

Court – Validity of Trust problematic, so there was never a trust

* Certainty of Intention: never intended to pass discretion to deal with shares, despite deed clear on intention;
	+ Trust at best agent in a gift from man to wife
* Certainty of Subject Matter – an element of ownership never passed;
* Certainty of objects (not argued in this case)
* Transfer of proper never effectively done

Even if trust valid, GAAR applies to treaties

* 2005 amendment on *245* includes reference to a tax treaty and made retroactive to 1988
* Treaty with Barbados from 1980 says treaty trumps domestic law;
* *4.1(1) of ITCIA*: ITA 245 applies to any benefit provided under the Convention
* Court: ITCIA later in time and crystal clear, it trumps Barbados Treaty

Application of GAAR

* Trust itself not abusive, but tax benefit attributed to individual TP is abusive and not protected by the Treaty
* Obvious tax benefit; Avoidance transaction: part of series of transaction whose sole purpose to avoid tax;
* Abuse: object, spirit and purpose of provisions frustrated: rollover not meant for avoidance, just deferral;

## Non-Arm’s Length Transactions

### Arm’s Length Principle

**OECD Art 9**

(1) Profit allocation between two NAL enterprises in respective KS should be the same as between independent enterprises

* NAL (a) enterprise of a KS participate D or inD in management, control or capital of another enterprise of another KS, or (b) same persons participate in D or inD in M, C and C of both enterprises in the two KS

(2) when due to (1), tax is levied on the same profits by both KS, state taxed due to NAL should make appropriate adjustment to tax. Due regard should be given to other provisions of treaty and competent authorities should be consulted.

OECD Art 7(2): profits of a PE same as if it were a distinct and separate enterprise dealing wholly independently with enterprise of which it is a PE; - ALP applicable to determination of profits attributable to a permanent establishment

### Transfer Pricing

#### Transfer Pricing Method

When applied correctly, the methods should result in an arm’s length price or allocation

* Pricing comparable, not necessarily identical to FMV, within reasonable range
* CRA: if possible, unbundle and set price separately for each transaction

Selection based on

* (a) nature and characteristics of property or services; (b) functions performed by parties; (c) contractual terms; (d) economic circumstances and business strategies of each parties

**Traditional Transaction Method – preferred by CRA**

Guideline in question – Alberta Printed Circuit

* *“Guidelines don’t supplant the need for a rigorous application of ITA in relation to a TP’s circumstances, and cannot be asserted to support what could be seen as a theoretically plausible outcome when the Act did not compel the application of those or indeed any particular methodology & the TP’s analysis and circumstances justified a more modest adjustment.”*

***Comparable Uncontrolled Price (CUP) Method***

* Best evidence of an arm’s length price;
* How: sets price similar to comparable NAL product sold in similar quantities, terms and markets
* When (GSK): none of the differences between T could materially affect price in open market, or reasonable accurate adjustments can be made to eliminate material effects of such differences;

***Resale Price Method***

* How: permits TP to subtract gross profit mark-up from price would have been sold to unrelated parties
	+ Can to US to unrelated party; If US charge $150 and similar profit marin 33%, price set at $100
* When: where related party adds relatively little value to goods prior to sale, like a related party distributor

***Cost Plus Method***

* How: TP adds appropriate profit % or mark-up to its cost of producing product or service prior to sale to NAL
* When: usually used for services; whenever possible, derive profit mark-u from comparable controlled sales by TP

**Transactional Profit Method – preferred in transfers of intangible unique property**

***Profit Split Method***

* When: CRA says ONLY when information on comparable transactions not readily available or is unreliable for the purposes of applying the traditional methods; suitable where
	+ transactions highly integrated and difficult to evaluate separate components of particular transaction;
	+ transaction involve unique transfers of intangible goods and service difficult to find comparable NAL transacti
* How: (i) determine total profit earned; (ii) split profit b/t parties based on relative value of contributions to NAL transactions, considering functions performed, assets used and risks assumed by each NAL party; (iii) may follow the residual profit method: first allocate routine return; then allocate residual profit;

***Transactional Net Margin method (TNMM)***

* How: compares net profit margins derived from a T involving related parties with **net profit margin** realized by unrelated parties from similar transactions; different from profit split method b/c apply only to one member;
* (i) select similar entities; (ii) screen to determine if entities comparable transactions, based on financial information available; (iii) check narrative descriptions for comparability; (iv) make appropriate adjustments when possible and eliminate entities where necessary adjustments cannot reasonably be made

#### Common Law

***GlaxoSmithKline, 2010***

Fact: Glaxo purchase Ranitidine and a licensing agreement from NAL; Used resale price method; MNR reassessed on CUP

Court : found for Glaxo – it was a bundle; licensing agreement must be taken into account

* Regard must be had to independent interests of each party, not just one

To demolish the basis of the assessment is to discharge its burden

* Here court found GSK hasn’t discharged the burden on all assumptions;

***General Electric Capital, 2010***

Fact: parent guarantees the financing of debt by subsidiary; started to charge a 1% fee;

Court: find for GECUS

* The explicit guarantee would boost the credit rating, according to expert witness
* Implicit Support should be considered in the comparison analysis, but actual fee still found to be reasonable

#### Statute

69(1):

Transfer Pricing Adjustment

**247(2)** where NAL dealing among following participants in a (series of) T: A TP and non-resident person; a partnership and non-resident person; a member of partnership and non-resident person; partnership and non-resident person that is a member of the partnership, AND (a) terms or conditions made or imposed b/t participants differ from those b/t AL persons, or (b) (series of) transactions (i) would not have been entered into b/t AL persons, and (ii) can reasonably be considered to have been entered into not primarily for bona fide purposes other than to obtain a tax benefit,

any amounts that, but for 247 and 245 would be determined shall be adjusted to the quantum of nature of the amounts would have been determined if (c) for (2)(a), terms and conditions had been like those b/t AR, or for (2)(b), transactions those would have been entered b/t AL under terms and conditions b/t AL;

**247(3)** TP liable to a penalty, if net result of adjustments under 247(2) exceeds lesser of 10% of TP’s gross revenue and 5M; Net adjustment: all upward adjustments minus upward adjustments for which there are reasonable efforts and discretionary downward adjustments for which there are reasonable efforts; - only where no reasonable effort

**247(4)** TP required to make or obtain certain records or documents on or before filing date, and provide them to Minister within 3 months of receipt of a written request to do so

**247(12)**: deemed dividend potentially subject to withholding tax

**17(1):** A resident corporation should include in its income interest income and income attributable to interest as calculated at reasonable rate, based on an amount owed by non-resident that has been outstanding for more than a year;

**69(1) General NAL rule**

1. Where TP acquires anything more than FMV from NAL person, deemed to acquire it at FMV;
2. Where TP dispose of anything for less than FMV to NAL person, by gift or to trust as disposition of property where beneficial ownership did not change, deemed to receive FMV;
3. When TP acquire property thr/ gift, inheritance or disposition not resulting in change of BO, deemed acquire @FMV

### Thin Capitalization

Target debt financing, real goal to protect Canadian tax base by preventing excessive use of interest deduction

* Though interest paid subject to withholding tax, it is deductible expense and not subject to double –taxable like dividends;

#### Statute

**18(4)** Limitation on Deduction of Interest

In computing income of a corporation or trust from a business or property, no deduction shall be made in respect of that proportion of any amount otherwise deductible in respect of interest paid or payable by it on ***outstanding debts to specified non-residents*** (third-party debt not considered) that *(exception: Canadian banking biz of an authorized foreign bank)*

* (a) amount by which (i) average of all amounts each of which is, in respect of a calendar month that tends in the year, the greatest total amount at any time in the month of outstanding debts to specified non-residents of the corporation or trust, exceeds (ii) 1,5 times the (book) equity amount of the corporation or trust for the year, is of
	+ (i) average of highest monthly outstanding debt exceeding (ii) 1.5 times the equity amount
* (b) the amount determined under (a)(i) for the year.
* *Non-Deductible: [(i) – (ii)]/(i)*

**18(5)** Definition

“equity amount”: (a) in the case of corporation resident in Canada, total of (i) retained earnings at beginning of year, excluding RE of any other corporation; (ii) average contributed surplus (by specified non-R SH) at beginning of each calendar month; and (iii) average paid-up capital excluding those in respect of shares owned by person other than specified non-R SH

“specified non-resident shareholder” SNR-SH: a specified SH of the corporation who was at that time a non-resident person or a non-resident-owned investment corporation

Specified SH: person who at that time, either along or together with NAL persons, owns

* (a) shares of capital stock w/ 25% or more votes, or (b) FMV of 25% or more of all issued & outstanding share
* [deemed to have exercised any option or rights to acquire shares/voting rights except when rights not exercisable unless death, bankruptcy or permanent disability of an individual]

“outstanding debts to specified non-residents”: outstanding debt or other obligation to (A) SNR-SH, or (B) non-resident person who’s NAL with SNR-SH (exception for foreign insurance companies and banks conducting Canadian biz)

18(6) Loans made on condition

IF any loan (first) has been made (a) by SNR-SH, or (b) non-resident person NAL with SNR-SH, to another person **on condition** that a loan (second) made by **any person** to a particular corporation or trust, for the purpose of (4) and (5), the lesser of the first and second loans is deemed to be debt incurred by the particular corporation or trust to person making first loan.

**Note**

* Only “book equity” considered; Third-party debt not considered;
* No carryover of interest expenses denied deduction; No similar rules of Canadian SH/lenders;
* No re-characterization of interest payment; interest may still be subject to withholding tax

#### Canada-US Treaty

*Art XXV(7)* except where provisions of Art IX (related persons), XI(interest) or XII(royalties) apply, interest, royalties and other disbursements paid by resident of a KS to resident of the other KS shall, for the purposes of determining taxable profits of first resident, be deductible under same condition as if they had been paid to a resident of the first State. Similarly, any debts of a resident of a KS to resident of the other KS shall, for the purpose of determining taxable capital of first resident, be deductible under same condition as if they had been contracted to a resident of first state;

* Interest, royalties and other disbursement paid by Resident of CAN to R of US;
* For R of CAN in calculating taxable profits, as if paid to another R of CAN;
* In case of debt, in calculating taxable capital, as if debt owed to another R of CAN;

*Art XXV(8)* Provision in (7) shall not affect operation of domestic tax law (a) relating to deductibility of interest that is in force when Treaty signed (including subsequent modifications), or (b) adopted after such date b CS and designed to ensure that non-resident person does not enjoy tax treatment more favorable that resident of that state;

***Specialty Manufacturing Limited, 1999***

Fact: SM borrowed form parent company at interest rate of the bank; Debt/Equity ratio =10M/100

Court: This is not a Arm’s Length Capital Structure, cannot use **Treaty Art 9** to justify (which requires NAL)

# Taxation on Non-Residents on Canadian Source Income – inbound

|  |  |  |
| --- | --- | --- |
|  | **Active Income** | **Passive Income** |
| **Inbound** *(tax on foreign income earned by Canadian resident)* |
| Direct | Part I Tax (on non-resident)* Employment; biz; some capital gain
* Tax on net income; progressive rates
 | Part XIII withholding tax 25%* Rent, royalties, dividends, interests
* Treaty reduce rate
 |
| Indirect (via CanCo) | Part I Tax (on CanCo) | Part I Tax (On CanCo) |
| **Outbound** (*tax on non-residents earning income in Canada)* |
| Direct | Part I tax (FTC)* Tax base belong to other country
 | Part I Tax (FTC limited to 15% foreign tax) |
| Indirect (through FA)  | Exemption System* FA not taxable
* Exempt dividends
 | Part I Tax(on income earned by FA & dividends, subject to credits and foreign taxes |

## Employment Income

### Domestic Rules

*248(1)* “salary or wages” def: income of a TP from O or E and includes all fees received for services not rendered in the course of TP’s business but not superannuation or pension benefits or retiring allowances;

*5(1)* TP’s income from office or employment is the salary, wages and other remuneration, including gratuities received

* Note: 5(1) narrower

**Non-Resident’s Employment Income Taxable in Canada**

*2(3)(a)* non-resident person who was employed in Canada at any time should pay income tax on taxable income

*115(1)(a)(i)* A NRP income from duties of O or E performed in Canada is taxable (when RP, O&E outside CAN)

* ***115(1)(a)(v)*** *– for NRP deemed employed in Canada, their taxable income, based on* ***115(2)(e),*** *include*
	+ (i) Indirect or direct remuneration paid by RP, **except** what’s attributable to performance outside Canada and (A) subject to income profits tax in another country, or (B) paid in connection with selling of property, negotiation of K or rendering of services for ER, FA or NAL of ER, in ordinary course of biz carried on by them;
	+ (ii) Canadian sourced scholarships/fellowships/bursaries/prizes & grants (iv) registered educat savings plan
	+ (v) Deductible amount by Canadian TP, paid to a NRP that can reasonably be regarded as consideration or partial consideration for K or remuneration or partial remuneration

Note: no reference to “income from property in Canada”, which is subject to Part XIII withholdin tax

**115(2) Deemed Employment in Canada**

If a NRP is (a) a full time student at post-secondary institution; (b) P ceased to be resident in preceding year as a student or teacher taking classes or teaching at post-secondary institution; (b.1) same for someone moving to do research

(c) ceased R in Canada preceding year, received salary/wages/other remuneration this year in respect of O or E paid by R of Canada, directly or directly, AND entitled to exemption for income tax in any other countries regarding them

(c.1) received deductible amount under K that’s reasonably considered (partial) consideration or remuneration

**Then** (d) NRP deemed to be employed in Canada for 2(3)

 (e) total taxable income under 115(1)(a)(v) includes

### Effect of Tax Treaties

**OECD Model**

15 (1) Subject to 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a KS-A in respect of an employment shall be taxable only in KS-A unless employment exercised in KS-B, in which case may be taxed KS-B;

(*salaries, wages & similar remuneration taxable only in resident state; MAY source jurisdiction where employment exercised, but reverts back to resident jurisdiction if employer isn’t paying tax in source state*)

 (2) Remuneration derived by resident of KS-A in respect of an employment exercised in KS-B taxable *only in KS-A if*

(a) Recipient present in KS-B for period not exceeding 183 days, and

(b) remuneration paid by, or on behalf of, employer not resident of KS-B, and

(c) remuneration not born by permanent establishment (PE) which the employer has in KS-B

(3) Remuneration derived in respect of employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in FS in which the *place of effective management of the enterprise* is situated. – Resident state of the employer can tax the employee

16 **Directors’ Fees:** paid to resident of KS-A as member of BoD by company resident of KS-B may be taxed in KS-B

**17 Artistes and Sportsmen** (may be source): income derived by R of KA-A as an entertainer, such as theatre, motion picture, radio or TV artiste, or a musician, sportsman, from his personal activities as such exercised in KS-B, may be taxed in KS-B

18 **Pensions**: subject to 19(2), pensions & similar Remu. paid to R of KS-A in consi of past employment taxable only in KS-A.

19 **Government Service**

(1)(a) for S, W or other Remu, exclusive taxing power to paying state, (b) except when serviced rendered in receiving state (B), payee resident of B, and is also a national or didn’t become resident for rendering services

(2)(a) Exclusive taxing power on paying state for *pensions* and similar Remu; (b) except taxable only in KS-B when individual resident and national of KS-B

(3) 15, 16, 17, 18 apply to S, W, pensions, and similar Remu in respect of services rendered in connection with a *business* *carried on by a KS* or a political subdivision or a local authority thereof.

**Canada-US Treaty Article XV Dependent Personal Services**

1. S, W and other similar Remu derived by R of KS-A in respect of employment shall be taxable only in KS-A unless employment exercised in KS-B. If so, such remuneration as is derived therefrom may be taxed in KS-B

* Source taxation for employment income

2. Notwithstanding 1, remuneration derive by R of KS-A in respect of an employment exercised in a calendar year in KS-B shall be taxable only in KS-A if

1. such Remu doesn’t exceed $10,000 in currency of KS-B, or
	1. **Prescott**: US-R works for Vancouver law firm, also SFU; claimed exemption for payment from SFU
		1. Held for TP: An” employment not all; Cannot aggregate amount for this limitation
2. recipient present in KS-B for period not exceeding 183 days that year, and Remu not borne by ER resident in KS-B or by a permanent establishment or fixed based which ER has in that other state

However, resident taxation if less than 10K, or less than 183 days AND employer no resident and no PE/fixed base (so if there would be no source taxation)

3. Notwithstanding 1 and 2, Remu derived by R of KS-A in respect of employment regularly exercised in more than one state on a *ship, aircraft, motor vehicle or train* operated by a resident of KS-A shall be taxable only in KS-A

### Common Law

#### Salary, wages and other similar remunerations

***Khabibulan*** –

Fact: Treaty b/t Canada and USSR says exclusive resident jurisdiction for income from public performance; hockey-player wants the “signing bonus” to be remuneration, so it would be taxed in Belarus;

Issue: derived from playing hockey, or for inducing to sign the contract? (if latter, under 115(2)(e)(v), taxable in Canada)

Court: Contract designed to give remuneration (from playing Hockey) TP so considered and paid in installment; Treay no tax

***Hale, 1992*** -

Fact: TP CEO of a Canadian company; moved to UK then exercised option. Argued employment not exercised in Canada during that year, so Canada cannot tax the benefit from the option;

Court: TP deemed to have exercised employment in Canada

***Gu, 1991*** – Chinese law student lost scholarship, had to work for a year b/t study; argue income exempt under Art 19 of treaty

Argument: Art 19 Payments students receive solely for the purpose of education/training shall not be taxed

Court: exemption doesn’t apply to salaries and wages, but must be for the purpose of education

#### Allocation of Income

**ITA 4(1)** Income or loss from a source(s) in a place (a) computed assuming no income/loss except in that place, deduction allowed only applicable to that source; (b) when partly in one place, calculate separately like in (a)

**Austin** – when language or Treaty of domestic law open-ended, most reasonable approach based on employment contract;

* Since he was paid per-game, tax more appropriate that way than per-day he spent in US and Canada

***Sutcliffe*** – airline employees taxable in US/CAN based on portion of flight over respective airspace

Fact: AC pilot, R-US, commute to Toronto; He flies both domestic and international flights.

Court: Treaty language is “employment exercised in Canada can be taxed by Canada”, so calculate portion of flight

## Business Income

### Domestic Rules

2(3)(b) A NRP who carried on a business in Canada at any time in the year or a previous year is subject to income tax

115(1)(a)(ii) Non-resident for whole year must include in taxable income from businesses carried on by NRP in Canada

253 Extended meaning of “carrying on business” – person or trust deemed to be carrying on biz in Canada if he/it

1. Produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada whether or not the person exports that thing without selling it before exportation
2. Solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract of transaction is to be completed inside or outside Canada or partly in and partly outside Canada, or
3. ***Disposes*** of (i) Canadian resource property, except inventory; (ii) property (other than depreciable property) that is a timber resource property, an option in respect of a timber resource property or an interest in, or for a civil law a right in, a timber resource property (iii) property (other than capital property) that is real or immovable property situated in Canada, including an option in respect of such property or an interest in, or for civil law a real right in, such property, whether or not the property is in existence

Most important judicial tests are ***where sales contracts are made*** and ***place of operations*** from which profits arise

**GLS Leaxco**

Fact: Michigan EP carry on biz in Canada through leasing property to affiliated company in Canada; little infrastructure in CAN;

Issue: company losing money; if carry on biz can avoid withholding tax since net income negative

Court: substance of doing biz in Canada in evidence

* No: control/management in US; no soliciting/offering for sale in CAN; no office/agent in CAN
* Yes: can use McK office for signing and mailing; all purchase orders in CAN$; CAN bank account; GLS intended to do biz in CAN; McK employees always available to help;

**Sudden Valley**

Fact: US company selling land in US, had phone/office/EE in Van, but just invite ppl, all sales K signed in US;

Court: not carrying on biz in Canada

* Not soliciting offers, just invitation to treat; Only activities in CAN inviting ppl for visit, too remote from real estate biz
* In the absence of other evidence, place of contract concluded decisive

**Maya Forestales**

Fact: Costa Rica company offering investment in teak tree plantation to Canadians. K signed in Canada through agent, then forwarded to CR; No treaty between Canada and Costa Rica

Court: 253(b) key word is “solicit in” not “in Canada”: though plantation in CS, this operation caught

 Profit-making activities in Canada, not all in CR – K through an agent;

### Tax Treaties

**OECD Art 7**

1. Profits of an enterprise of KS-A shall be taxable only in KS-A unless enterprise carries on business in KS-B through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of 2 may be taxed in KS-B

* Resident jurisdiction for enterprise, but source jurisdiction if carry on biz through PE, for profits attributable to PE

2. For the purposes of this Article, profits that are attributable to each KS to the PE are profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the PE and through the other parts of the enterprise.

* Profits attributable to PE: profits expected to make if it were separate/independent, in similar situation

3. Where, in accordance with 2, KS-A adjusts profits attributable to a PE of an enterprise of one of the KS and taxes accordingly profits of the enterprise that have been charged to tax KS-B, KS-B shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of tax charged. In determining such adjustment, the competent authorities of the KS shall if necessary consult each other

* If KS-A adjust profits attributable to a PE, resulting in profits taxed in both KS, KS-B try to avoid double-taxation

4. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article

* Other Articles can override Article 7

**OECD Art 5 Permanent Establishment**

**1. Definition of PE -** a fixed place of biz through which the biz of an enterprise is wholly or partly carried on

* ***Place of Biz***: any premises, facilities or installations used for carrying on biz, whether or not used exclusively for that purpose; may be a pitch in a market place, or in biz facilities of another EP; No formal legal right to space required
* ***Fixed Place***: link b/t biz and a geographical point; degree of permanent, but immaterial how long, just distinct place; even if multiple locations, still fixed place if they constitute a coherent whole commercially and geographically
* ***Biz carried on through fixed place***: any situation where biz carried on at a particular location at the disposal of the enterprise for that purpose

2. PE includes especially a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, an oil or gas well a quarry or any other place of extraction of natural resources

3. A building site or construction or installation project constitutes a PE only if it lasts more than 12 months

4. PE shall be deemed not to include

1. Use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to enterprise
2. Maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of S, D & D.
3. Maintenance of a stock of G or M belong to enterprise solely for the purpose of processing by another enterprise
4. Maintenance of a fixed place of biz solely for purchasing G or M or of collecting information for the enterprise
5. Maintenance of a fixed place of biz solely for carrying on, for enterprise, any other activity of a preparatory or auxiliary character
6. Maintenance of a fixed place of biz solely for any combination of activities above, provided overall activity preparatory or auxiliary in character.

5. Dependent Agent Rule

Where a person, other than an agent of an independent status under 6, is acting on behalf of an EP and has, and habitually exercises, in a KS an authority to conclude contracts in the name of the EP, that EP shall be deemed to have a PE in that state in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned 4 which, if exercised through a fixed place of biz, would not make this fixed place of biz a PE

* EP deemed to have a PE if a person habitually exercise authority to conclude K in name of EP, unless 4 applies

6. Indeterminate Factor

An enterprise shall not be deemed to have a PE in a KS merely because it carries on biz in that state through a broker, general commission agent of any other agent of an independent status, provided that such persons are acting in the ordinary course of their business – EP not deemed to have PE if person is agent of independent status in ordinary course of his biz

* Depends on the extent of obligation: not independent if detailed instructions, comprehensive control; entrepreneur risk born by person or EP; Less likely independent if only one client for the agent;
* Authority to conclude K includes when contract not in EP’s name but binding it; also true if K signed another state
* “habitual exercise” depends on nature of K an biz;

7. The fact that a company which is a resident of KS-A controls or is controlled by a company R-KS-B, or which carries on biz in KS-B (through PE or otherwise), shall not of itself constitute either company a PE of the other

* Just because you have a Sub in a state does not mean you have a PE automatically – separate legal entities

**Canada-US Treaty Art V**

Basically the same as OECD, but “resident” instead of “enterprise”

Addition

4. the use of an installation or drilling rig or ship in a KS to explore for or exploit natural resources constitutes PE if and only if such use is for more than 3 months in any 12-month period

6. US treaty specifically mentions advertising activities; It also does not mention combination of activities;

9. Subject to 3, where an EP of KS-A provides services in KS-B, if EP found not to have a PE in KS-B by virtue of the preceding paragraphs of Art V, EP shall be deemed to provide those services through a PE in KS-B if and only if

1. Those services performed in KS-B by an individual who is present in KS-B for a period(s) aggregating 183 days or more in any 12-month period, and during which more than 50% of gross active biz revenues of EP consists of income derived from services performed in KS-B by that individual, or
2. Services provided in KS-B for 183 days or more in any 12-month period with respect to the same or connected project for customers who are either residents of KS-B or who maintain PE in KS-B and services provided in respect of that PE

**Dudney, 2000 – likely changed by this provision**

Fact: US citizen hired by US company to perform in CAN; not identified as working for CAN company;

Court: No PE in CAN; No control over the premises he has to work; analogy to lawyer meeting client;

**Canada-UK Treaty Art 14 Professional Services**

Otherwise basically the same as OECD

1. Income derived by R-KS-A in respect of professional services or other independent services of a similar character shall be taxable only in KS-A unless he has a fixed base regularly available to him in KS-B for the purpose of performing his activities. If he has such a fixed base, income may be taxed in KS-B, but only so much as attributable to that fixed base

2. The term “professional services” includes independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

### Common Law on Permanent Establishment/Fixed Base

**Fowler – PNE knife-seller - PE**

Fact: TP sell knives in fairs; Carry on biz in PNE 2-3 weeks/yr for 15 yrs. Non-exclusive license; movable equipment;

Court: PNE is a PE

* Significant proportion of his biz; Nature of biz: booth the same as management or office
* Permanent doesn’t have to be continuous, can be recurring

**Knights of Columbus**

Carrying on Biz Analysis: YES under 253(b) soliciting biz through agent or servant

Dependent agent PE - NO

* Chief Agent – independent – hourly fee and reimbursed for expenses, like I-Contractor
* General Agent – independent – recruit & train FA, home office, income from commission; Court: separate biz
* Field Agent – dependent but no authority to conclude K – K control by US ppl; Temp K promotional gift, only biz perm

Fixed Based PE – NO - Field Agents have place of biz, but not Knight’s place of biz, Knight does not have control of premise

Note: no insurance premium Art from UN model; Reciprocity, US and CAN consciously decided not to include

### Allocation of Income/Source

**ITA 4** Profit or loss from a source(s) in a place (a) computed assuming no income/loss except in that place, deduction allowed only applicable to that source; (b) when partly in one place, calculate separately like in (a)

***Income Tax Conventions Interpretations Act* 4 PE in Canada**

Profits from biz activity (includes investment or commercial) attributable to PE in Canada includes

1. All amounts with respect to activity attributable to PE AND would be required under ITA, as amended to be included in R-CAN COB in CAN’s income from biz, unless convention expressly provides otherwise
2. Not to be deducted any amount with respect to activity attributable to PE and would not be deductible under ITA, as amended, by resident person COB in Canada in computation his income from biz, unless agreed b/t competent authorities otherwiseC

Generally, rules applying to residents for computation of income from biz apply equally to non-residents.

**OECD Art 7**

1. Resident jurisdiction for enterprise, but source jurisdiction if carry on biz through PE, for profits attributable to PE

2. Profits attributable to PE: profits expected to make if it were separate/independent, in similar situation

* ***Cudd Pressure*** – US company w/ PE in Canada; Canada branch “notional rented” US unique equipment
	+ Cannot deduct rent as expense; Not independent entity in CAN;

3. If KS-A adjust profits attributable to a PE, resulting in profits taxed in both KS, KS-B try to avoid double-taxation

4. Other Articles can override Article 7

**Sumner and Roxanne Music**

Fact: Sting set up Roxanne (R-US), pays Sting 96% net profits of NA tour.

Is Roxanne liable for tax in CAN? – Yes; US-CAN Treaty XVI Artistes and Athletes, source jurisdiction exceeding 15K

* Sting clearly participate in profits; Interpretation bulletin: contemplates where performers’ income earned part by im personably and part by company and both may be taxed;

Allocation **-** TP: 6/240 days in CAN; MNR: gross CAN income/gross NA tour income; MNR won

## Capital Gains and Losses

**2(3)(c)** NRP who disposes of a taxable Canadian property is subject to income tax in Canada

**115(1)(a)(iii)** NRP’s taxable income include taxable capital gains from disposition described in 115(1)(b)

* **115(1)(b)** the only taxable capital gains & allowable capital losses referred to in 3(b) were those from dispositions of taxable Canadian property, other than treaty-protected properties – *cannot offset w/ capital loss from non TCP*
* 248(1) “Treaty-protected properties”: property any income or gain from the disposition of which by the TP exempt from tax because of a tax treaty

**116** Purchaser has to withhold part of the purchase price for tax owing by the vendor

Information Circular 72-17R6

*248(1)*

*“taxable Canadian property”*

1. Real or immovable property situated in Canada
2. Business assets of a biz carried on in Canada
	1. (other than property used in carrying on insurance biz AND dispositions of ships & aircraft used principally in international traffic & related personal property by NRP, if NRP’s resident country doesn’t tax gains on R-CAN
3. if TP an insurer, its designated insurance property for the year
4. a share of the capital stock of a corporation (other than mutual fund) that is not listed on a designated stock exchange, an interest in a partnership or trust, if, at any particular time during 60-month period ends at that time, more than 50% of FMV of share/interest derived directly or indirectly from one or combination of
	1. (i) real or immovable property in Canada; (ii) Canadian resource properties; (iii) timber resource properties, and (iv) options, interest, civil law rights in property in (i)(ii)(iii), whether or not property exists
5. A share of capital stock of a corporation listed on a designated stock exchange, of a mutual fund corporation/unit of mutual fund trust, at any time during 60-months, (i) 25% or more shares of any class or issued units of trust, were owned by or belong a combination of (A) TP; (B) NAL of TP, and (ii) more than 50% FMV of share or unit derived directly or indirectly from one or any combination of properties described under (d)(i) to (iv), or
6. An option, interest, civil law right in property in (a) to (e), whether or not property exists,

g-k) Canadian resource property and timber resource property, income interest in trust, income interest in a Canadian partnership, and life insurance policy in Canada

Note: (d) and (e) could lead to the same piece of property being taxed multiple times

**Placrefid**

Fact: Panama incorporated company owns property holding company in CAN; Mirlaw closing on it; two separate options for PanCo to buy the property; 1st 250K deposit; 2nd said if Mirlaw changes mind, pay 250K back. - Issue: Is the 250K TCP

Court: held for TP

* Not a Capital Gain: Mirlaw had no property rights yet (still waiting for court), cannot legally grant an option
* Not AINT, but COB: purpose of dealing salvaging real estate investment, 250K directly related to this
* No PE: agent did not have power to habitually conclude K

**OECD Art 13**

1. Gains derived by R-KS-A from alienation of immovable property and situated in KS-B may be taxed in KS-B

2. Gains from alienation of movable property forming part of biz property of a PE, which an EP of KS-A has in KS-B, including such gains from alienation of such a PE (along or with whole EP) may be taxed in KS-B.

3. Gains from alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircrafts or boats, shall be taxable only in the KS where place of effective management of the EP is situated

4. Gains derived by R-KS-A from alienation of shares deriving more than 50% of value D or inD from immovable property situated from IS-B may be taxed in KS-B

5. Gains from alienation of any other property taxed only in resident KS (KS of which alienator is resident)

Default Resident jurisdiction;

Source jurisdiction if: immovable property; movable property part of biz property of PE; shares more than 50% value from immovable property in source country; place of central management and control for ships, aircrafts, etc;

**Canada-US Treaty Art XIII**

1. Gains derived by R-KS-A from alienation of real property situated in KS-B may be taxed in KS-B

2. Gains from alienation of personal property forming part of biz property PE, which R-KS-A has in KS-B (within 12-month preceding date of alienation), including gains from alienation of PE, may be taxed in KS-B

3. “Real property situated in the other KS (KS-B)” (a) in the case of real property in US, means US real property interest and real property, but does not include share of capital stock of a company not resident of US; (b) in the case of real property in Canada, include (i) real property; (ii) share of capital stock of a company resident of Canada, value of whose shares derived principally from real property in Canada, and (iii) interest in a partnership, trust or estate, value of which derive principally from real property in Canada

* *US: just real property; CAN: also shares of Co, interest in PS/trust/estate whose value principally from property in CAN*

4. Gains from alienation of any other property taxable only in resident KS.

5. KS-A can still levy tax on gains from alienation of any property derived by an individual R-KS-B is

1. Individual resident of KS-A (i) at least 120 months during preceding 20 years preceding alienation, & (ii) at any time during 10 years immediately preceding alienation, AND
2. Property (or substituted property gain not recognized for tax in KS-A) (i) owned by individual at the time he ceased to be resident of KS-A, and (ii) not property individual was treated as having alienated by reason of ceasing to be R-KS-A and becoming R-KS-B

Notwithstanding 4, original resident country can tax if resident for 10 of past 20 years, or anytime past 10 years, AND property owned at time of resident change + not sold for reason of resident change

6. Where individual (non-citizen of US) was R-CAN became R-US, in determining liability to US in respect of gain fro alienation of principal residence in CAN owned by him at time tease to be R-CAN, adjusted basis no less than FMV

7. Where individual treated by KS-A as having alienated property and taxed, he may elect to be treated for the purposes of taxation in KS-B as if he had, immediately before that time, sold and repurchased property equal to FMV

8. Where R-KS-A alienates property in the course of corporate or other organization, reorganization, amalgamation, division or similar transaction and profit, gain and income with respect not recognized for tax in KS-A, if requested to do so by person acquiring property, competent authority of KS-B may agree, to avoid double taxation and subject to terms and conditions satisfactory to it, defer recognition of profit, gain or income in KS-B until stipulated in agreement

9. Where person R-KS-A alienates capital asset which may be taxed in KS-B and (a) person owned asset on Sep 26, 1980 and resident in KS-A on that date, or (b) asset acquired by that person in alienation of property which qualified as a non-recognition transaction for tax purpose in KS-A; the amount of gain liable to tax in KS-B shall be reduced by proportion of gain attributable on a monthly basis to the period ending on Dec 31 of the year Convention enters into force, or such greater portion of gain as is shown to the satisfaction of competent authority of KS-B to be reasonably attributable to that period. “Non-recognition transaction” includes T to which 8 applies and for US tax, T that would have been a NRT but for some provision in Revenue Code

Non-Recognition T in Para 8 reduces tax in KS-B

Provision shall not apply to (c) asset on Sep 26, 1980 form part of biz property of a PE of R-KS-A situated in KS-B; (d) alienation by R-KS-A of an asset owned at any time before date and before such alienation by a person not at all times after that date while asset was owned by such person R-KS-A (owned by person not always R-KS-A), or (e) alienation of asset acquired by person anytime after date and before alienation in a transaction other than NRT

## Income from Properties

### Dividends and Repatriation of Branch Profits

**212(2) Tax on dividends**

Every NRP shall pay income tax of 25% on every amount that a corporate resident in Canada pays or credits, or is deemed to, to NRP on account of/in lieu of payment of/in satisfaction of (a) taxable dividend, or (b) capital dividend

Note:

* Payer doesn’t have to be dividend-distributing corporation
* CanCo borrowing Canadian stock in the course of a foreign biz still have to withhold on in-lieu-of payments (should have been no withholding on the underlying dividend)
* CanCo borrowing foreign security and COB in Canada required to withhold 25% in –lieu-of payment on borrowed stock (even if underlying dividend had been subject to foreign withholding)

**214(3)(a) Deemed dividends from Corporate Resident**

Where 15 or 56(2) would require an amount to be included in TP’s income, it shall be deemed to have been paid to TP as dividend fro a corporate resident in Canada

* 15: shareholder benefits; 56(2): indirect benefits

**ITA Part XIV Additional (Branch) Tax on Non-Resident Corporations**

When NRP operate through a subsidiary, NRP subject to both income tax and dividend withholding tax;

When NRP operate through a branch, NRP only subject to income tax; To remedy this, a branch tax is imposed

**219** Branch tax of 25% imposed on all foreign (NR) corporations COB in Canada on any after-tax earnings not reinvested in the Canadian business.

* 219(2) Exemptions from branch tax for Co principal biz was (i) transportation of persons or goods;

(ii) communications; or (iii) mining iron ore in Canada;

**219.2** Limitation on rate of branch tax

Where an agreement or convention b/t Canada & another gov’t that has force of law in Canada

(a) doesn’t limit rate of tax under this Part on corporations resident in that other country, and (b) provides that, where a dividend is paid by a CR-CAN to a CR other country that owns all shares of capital stock of CS-CAN, the rate of ta imposed on dividend shall not exceed a specified rate,

any reference in 219 to a rate of tax shall be read as reference to the specified rate

*Where treaty doesn’t limit branch tax rate, but limit withholding tax rate on dividend, branch tax rate should match it*

***RMM Canadian Enterprises Inc.***

Fact: That case involved a series of transactions intended to effect a windup of the Canadian subsidiary (“Subco”) of a US corporation (“the vendor”), without incurring any Canadian dividend withholding tax. Rather than winding up Subco into the vendor, a new Canadian company (“RMM”) was formed by an unrelat­ed person to purchase the Subco shares from the vendor. In ruling against the tax­payers, Bowman J concluded, inter alia, that RMM and the vendor were not, in fact, dealing at arm’s length. In his view, RMM was a “vehicle or instrumentality to assist in extracting [the vendor’s] surplus,” with no independent role in the transactions.

**OECD Art 10 Dividends**

1. Dividends paid by a company which is R-KS-A to a R-KS-B may be taxed in KS-B (beneficiary’s resident)

* *the language of “paid of” formalistic and easily manipulated; that’s why “beneficial ownership” introduced*

2. However, such dividends may be taxed in KS-A of which the company paying dividends is a resident and according to laws in KS-A, but if the **beneficial owner** of the dividends is R-KS-B, the tax so charged shall not exceed

1. 5% gross amount of dividend if BE is a company (other than partnership) which holds directly at least 25% of capital of the company paying dividend, or b) 15% of gross amount of dividends in all other cases

Can source (payer) juris; Reduced rate of withholding for beneficial ownership, more substantial more reduced

3. “dividends” means income from shares, “joissance” shares/rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to same taxation treatment as income from shares by laws of resident State of which country making distribution

4. 1 and 2 not apply if BE of dividends, R-KS-A, COB in KS-B, which is resident country of company paying dividends through PE and holding in respect of which dividends paid effectively connected with PE, since Art 7 applies

* If dividends paid to BO by Cop COB through PE, Art 7 Business Income applies, not dividends

5. Where company R-KS-A derives profits or income from KS-B, KS-B may not impose any tax on dividends paid by it, except insofar as dividends paid to resident of KS-B or holding in respect of which dividends paid effectively connected with PE in B, nor subject the company’s undistributed profits to tax even if dividends paid or undistributed profits consist wholly or partly of profits or income arising in KS-B

* Rules out extra-territorial taxation of dividends: source jurisdiction only when dividends paid to resident of source country, or profits generated from PE in source country;

**Prevost Car － *On Beneficial Ownership***

Fact: PC owned 100% by PHBV, which is owned 51% by Volvo and 49% by Hanly; SH greeent: profits of PC and PHBV distributed up to 80% to V & H; PC and PHBV shared some directors, would pay dividends w/o SH approval sometimes;

Issue: Who is the BE? V & H from UK & Sweden, 10% withholding tax; PHBV Netherland, 5%;

Court: ***BE – unfettered right to use & enjoyment of income; assumes risk and control of dividend received;***

* Conduit: must have ZERO discretion on distribution of dividend, even legally; court won’t piece corporate veil otherwise – in this case PHBV itself not party to agreement, so V&H can’t legally force it to follow dividend policy

Note: could use “Treaty-Shopping” provisions to combat this

### Management and Administration Fees

**212(1)(a)** Every NRP shall pay income tax of 25% on what a RP in Canada pays or credits, or deemed so, to the NRP on account of, in lieu of payment of, or in satisfaction of a management or administration fee or charge

**IT-468R**

* M&A fee not defined in ITA, include functions of planning, direction, control, coordination, systems or other functions at a managerial level.
* Whether constitute M&A Fee determined on basis of nature of services performed; look for substance not form; salary not M&A but may be subject to Part I tax.

Part XIII or Part I Tax

* If M&A not defined in Treaty, dealt as biz profits, 212(1)(a) not apply
* If M&A is defined
	+ Fees connected to PE in Canada, dealt as biz profits, 212(1)(a) not apply;
	+ Fees NOT connected to PE, 212(1)(a) apply, Part XIII tax reduced to specified rate
* If M&A fee dealt as biz profits,
	+ NOT COB through PE, no Canadian tax on NRP
	+ YES COB through PE, Part I tax; unreasonable fees disallowed as expense

**212(4)** “management or administration fee or charge” does not include any amount paid or credited or deemed so to a NRP (a) a service performed by NRP if at the time performed (i) service performed in the ordinary course of biz carried on by NRP that included the performance of such a service for a fee, AND (ii) NRP and payer dealing at arm’s length, or (b) a specific expense incurred by the NRP for the performance of a service that was for the benefit of the payer, to the extent that amount so paid or credited was reasonable in the circumstances

* **251(1)** Arm’s Length (a) related person deemed NAL; (b) TP & personal trust deemed NAL if TP, or TP’s NAL, would be beneficially interested in trust; and (c) any other case, a question of fact whether AL or NAL

**IR-468R**

* Specific expense: combination/portion or distinct expenses like overhead including rent, power, heat, salaries, fringe benefits and other biz expenses; It is a net expense
* Duplicated services not for the benefit of payer
* Reasonableness is a matter of fact, determination of which based on the quantum or amount of the exclusion sought in relation to service performed and benefit derived;
	+ Not only expenses, but method of allocation/distribution must be reasonable
	+ Unreasonable portion may be taxed as deemed dividends

### Interest Income

Interest generally means return or compensation for use or retention by one person of a sum of money belonging to or owed to another; (1) return or consideration for use of money; (2) accrues daily (3) computed by reference to principal amount

**212(1)(b)** Every NRP shall pay income tax of 25% on what a RP in Canada pays or credits, or deemed so, to the NRP on account of, in lieu of payment of, or in satisfaction of interest that

(i) Is not fully exempt interest and is paid or payable (A) NAL w/ payer, or (B) NAL in respect of debt or other obligation to pay an amount to NAP, or (ii) is participating debt interest;

**212(3)** Interest –Definition

**“**fully exempt interest”: (a) interest paid or payable on a bond, debenture, note, mortgage, hypothecary claim or similar debt obligation of or guaranteed by the government – CAN, province (agent), municipality, hospital/education institution if guaranteed by gov’t, or Crown corporation;

(b) interest paid or payable on mortgage, hypothecary claim or similar debt obligation secured by, or on agreement for sale with respect to, real property or immovable situated outside Canada or an interest in it, except when interest payable deductible for Part I tax from COB by payer in CAN, or property other than real or immovable outside CAN

(c) interest paid or payable to a prescribed international organization or agency, or

(d) amount paid or payable or credited under a securities lending arrangement

“participating debt interest”: interest other than in (b)-(d) paid or payable on an obligation, other than a prescribed one, all or any portion of which interest is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to SH of any class of shares of the capital stock of a corporation

Fully Exempt Interest: Canadian non-contingent gov’t debt, real/immovable mortgage in CAN, etc

Participating debt interest: contingent on use/production from CAN property, revenue/profit/cash flow/etc, dividend

**NRP deemed resident – base erosion**

**212(13)(f)** A NRP deemed to be resident in Canada if pays/credits, on account/in lieu of/on satisfaction of interest on any mortgage, hypothecary claim or other indebtedness entered into/issued/modified after Mar31, 77 and secured by real property or immovable situated in Canada or an interest therein, to the extent that amount deductible in computing NRP’s taxable income in Canada, or Part I income

* 212(13.2) when NRP-A pays/credits such an interest to NRP-B, he is deemed resident in Canada if interest deductible in his taxable income (Part XIII) from a source neither treaty-protected biz or property.

NRP deemed R in respect of interest if he pays it on debt secured by real or immovable property in Canada, which is deductible in computing NRP’s Part I or other income in Canada; Even if paying interest to another NRP

**Deemed Interest: gains on transfer of debt; guarantee fee; standby charges**

**For withholding tax purposes**

**214(7)** (a) where NRP assigned/transferred to a RP a debt obligation (bond, debenture, bill, note, mortgage, hypothecary claim or similar), and obligation issued by R-CAN, not excluded obligation like exempt interest or public issue security, and not assigned back to a resident who assigned it to NRP in the first place,

* difference b/t price assigned & issued deemed to be a payment of interest on the obligation made by R to NRP

**214(6)** This deemed payment of interest shall be included in NRP’s (Part XIII) income when obligation assigned (and subject to withholding tax)

**214(15)** (a) where NRP entered into agreement to guarantee repayment of principal amount of a debt obligation of R-CAN, consideration for the guarantee deemed to be a payment of interest on the obligation; (b) if NRP agree to lend money or make money available to R-CAN, consideration for the agreement deemed payment of interest if NRP would be liable for tax in respect of interest payable on any obligation issued

Swiss Bank Corporation

Lehigh Cement Ltd.

**OCED Art 11 Interest**

1. Interest arising in KS-A and paid to R-KS-B may be taxed in KS-B (payee juris)

2. However, such interest may also be taxed in KS-A, but if beneficial owner of the interest is R-KS-B, tax so charged shall not exceed 10% of gross interest. Competent authorities of KSs settle mode of application by mutual agreement

3. “interest” means income from debt-claims of every kind, whether or not secured by mortgage or carrying a right to participate in debtor’s profits, and in particular, income from gov’t securities and bonds/debentures, including premiums and prizes attaching to them. Does not include penalty charges for late payment

4. 1 and 2 does not apply if BO of interest, R-KS-B, COB in KS-A through PE and debt-claim in respect of which interest paid effectively connected with PE; In which case Art 7 apply

5. Interest deemed to arise in KS-A when payer R-KS-A. Regardless of residency or not, if payer has PE in KS-A out of which debt and interest borne, such interest deemed to arise in KS-A.

6. Where, by reason of special relationship b/t payer and BO or b/t both of them and some other person, interest exceeds amount b/t non-related parties, this provision applies only to AL amount. Excess payment remains taxable according to domestic laws.

When payer country taxes BO in payee country, tax not exceeding 10% gross interest;

This reduced withholding tax does not apply when (a) BO COB in KS-A through PE; (2) excess payment b/t NAL

Deemed interest arise in KS-A is (1) payer R-KS-A; (2) payer PE in KS-A where interest arise

### Rent, Royalties and Similar Payments

**212(1)(d)** Every NRP shall pay income tax of 25% on what a RP in Canada pays or credits, or deemed so, to the NRP on account of, in lieu of payment of, or in satisfaction of rents, royalties, etc, ***including payments***

(i) for use or right to use in Canada any property, invention, trade-name, patent, trade-mark, design or model, plan, secret formula, process or other thing whatever,

* *Not outright purchase or assignment of patent unless payment dependent on use*

(ii)for info concerning industrial, commercial or scientific-ICS experience where total amount payable as consideration for info is dependent in whole or in part on (A) use or benefit from it (B) production or SOG of services, or (C) profits

* *Doesn’t matter where info obtained except for (x) purpose;*

(iii) for services of an ICS character performed by NRP where total payable as consideration dependent on (A)(B)(C), but not including payment made for services performed in connection with sale of property or negotiation of contract

(iv) made pursuant to agreement b/t RP and NRP under which NRP agrees not to use or not to permit any other person to use things in (i) and (ii)

(v) dependent on use of production from property in Canada whether or not an installment on sale price, but not installment on sale price of agricultural land

**Not including**

(vi) royalty or similar payment in respect of a copyright in respect of the production or reproduction of any literary, dramatic, musical or artistic work (including computer programs)

(vii) payment in respect of use by railway company or person whose principal biz that of a common carrier or property that is railway rolling stock (A) if payment made for use of property for period not expected to exceed in aggregate 90 days in any 12 month, or (B) any other case, if payent made pursuant to an agreement in writing before Nov19, 1974

(viii) payment made under bona fide cost-sharing arrangement where payee shares on a reasonable basis with one or more NRP R&D expenses in exchange for an interest in any property or other valuable that may result

(ix) rental payment or use or right to use outside Canada any tangible property

(x) if payer (AL) can deduct interest expense as COB in a foreign country, so does not erode Canadian tax base

(xi) payment made to AL of payer for use or right to use property that is aircraft and things related to aircraft

**212(13)(a)** NRP deemed resident in respect of payment of rent for use in Canada of property (not rolling stock)

* But if property outside of Canada, no tax under 212

**Treaties on Immovable/Real Property**

**OECD Art 6 Income from Immovable Property**

1. Income derived by R-KS-A from immovable property in KS-B may be taxed in KS-B

2. “Immovable property” has meaning in domestic law of KS where it’s situated, and include property accessory to IP, livestock and equipment used in agriculture and forestry, rights to which general law respecting landed property apply, usufruct of IP and rights to variable or fixed payments as consideration for working and right to work mineral deposits, sources and other natural resources; NOT include ships, boats and aircraft

3. 1 apply to income derived from direct use, letting, or use in any other form of IP

4. 1 and 3 apply to income from IP of an enterprise.

**Canada-UK Treaty Art 6**

Very similar to OECD;

except **4**. 1&2 not apply in come from IP of an EP and to income from IP used for performance of professional services

**Canada-US Art VI Income from Real Property**

1. Income derived by R-KS-A from real property situated in KS-B may be taxed in KS-B.

2. “real property” has meaning in domestic law of KS where it’s situated, and include any option or similar right in respect thereof. It include usufrust of real property, rights to explore or exploit mineral deposits, sources and other natural resources, & rights by reference to amount/value of product from such sources; NOT ships and aircraft

3. 1 apply to income derived from the direct use, letting or use in any other form of real property and to income from alienation of such property

**Treaties on Royalties**

**OECD Art 12 Royalties**

1. Royalties arising in KS-A and beneficially owned by R-KS-B shall be taxed only in KS-B – exclusive payee-R juris

2. “Royalties” means payments of any kind received as consideration for use, right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience

3. 1 not apply if BO of royalties, R-KS-A, COB in KS-B in which royalties arise through PE and connected to it - Art 7

4. Where, by reason of special relationship b/t payer and BO, or b/t them and other person, amount of royalties paid exceeds amount b/t AL people, this article apply only to AL amount. Excess part remains taxable under domestic law;

**Canada-US Art XII Royalties**

1. Royalties arising in KS-A and paid to R-KS-B may be taxed in KS-B

2. Such royalties may also be taxed in KS-A (payor); but if R-KS-B is BE, tax shall not exceed 10% of gross royalties

* When payor juris, beneficial owner - tax not exceeding 10%

3. Notwithstanding 2, only KS-B (payee) may tax

1. copyright royalties and like payments in respect of production or reproduction of any literary, dramatic, musical or artistic work (other than payments IRO motion pictures and works on film, videotape or other means of reproduction for use in connection with TV) – Payor Juris on TV related stuff
2. payments for use of, or right to use, computer software (c) patent or info concerning industrial, commercial or scientific experience (**not** including info provided in connection with a rental or franchise agreement), and (d) payments with respect to broadcasting as may be agreed

4. “royalties” means payments of any kind received as consideration for use/right to use/copyright of literary, artistic or scientific work (including TV), patent, trade mark, design or model, plan, secret formula or process, use/right to use tangible personal property or info concerning ICS experience, and gains from alienation of intangible property or rights to the extent that such gains contingent on productivity, use or subsequent disposition of such property or right

5. 2&3 don’t apply if BO, R-KS-A, COB in KS-B through PE connect with royalties, in which case Art 7 apply

6. (a) Royalties deemed to arise in KS-A when payer R-KS-A. Regardless of residency or not, if payer has PE in KS-A out of which debt and interest borne, such royalties deemed to arise in KS-A (b) where (a) doesn’t operate to treat royalties as arising in either KS and royalties are for use/right to use intangible property or tangible personal property in KS-A, deemed to arise in KS-A

7. Where, by reason of special relationship b/t payer and BO, or b/t them and other person, amount of royalties paid exceeds amount b/t AL people, this article apply only to AL amount. Excess part remains taxable under domestic law

8. where R-KS-A pay royalties to person in 3rd country, KS-B may not impose any tax except when arise in KS-B or right or property on which royalties paid effectively connected with PE there

**Canada-UK Treaty Art 12**

Very similar to US one; except no 3(d) broadcasting; 4 – no mention of gain; no 6(b)

8 is different: Article shall not apply if main purpose or one of main purposes of any person concerned with creation or assignment of rights in respect of which royalties are paid to take advantage of this Article

***Saint john Shipbuilding & Dry Dock*** – definition of “rent” and “royalties”

Fact: US-Co software; can use but can’t share; info is yours; fixed front payment; back when treaty says rent and royalties, no “similar payment”; Ratio may not be useful today

Court: this is not rent or royalties

“**rent**”: property reverts back after some time or event, not lump sum for indefinite use without regard to how much used

“**royalties**” connotes payment calculated by reference to use/production/revenue/profits from the use of rights granted

**Vauban Productions –** royalties vs proceeds from transfer

Fact: NRP, no PE, w/ distribution right of films assigned it to a CAN TV producer; obligation to return copies back, etc

Court: royalties not proceeds from transfer because there are residual rights not transferred;

**Transocean Offshore Limited**

Fact: CAN oil company wanted to rent oil rig from Transocean, then both abandoned K; Tran received amount roughly same as rent; Crown argue settlement for rental K “in lieu of rent” though K never performed and should be subject to withholding tax

Court: find for Crown; “in lieu of” would be meaningless if interpreted to include only payments made as compensation for past or current use of property; Parliament must intend to include payments other than those with legal character of rent

**Pechet**

Fact: ITA 216 allow election for NRP to pay Part I income tax instead of Part XIII withholding tax; NRP did so after 2 years; Tax authority charged it with interest expense on withholding tax before time of filing

Court: ***216 does not eliminate responsibility of Canadian resident to withhold and remit;***

* change in tax liability occur upon filing of Part I return; no period concurrent liability;

# Taxation of Canadian Residents on Foreign Source Income – outbound?

## Elimination of Double Taxation

### Foreign Tax Credit and Deductions - 126

**Folio S5-F2-C1**

A foreign tax credit is a deduction from the taxpayer’s Canadian tax otherwise payable that may be claimed in respect of foreign ***income or profits tax*** paid by the taxpayer for the year.

TP may claim foreign tax credit equal to the lesser of (a) applicable foreign income or profits tax paid, and (b) Canadian tax otherwise payable for the year pertaining to the applicable foreign income – (1)(2)

* only “qualifying income or loss” from a country, means it’s from sources in that country (6)(d)

Ordering Rule (126(2)(c)) - Must deduct NBI tax before BI tax

On calculating FTC, TP must separate FNBI tax and FBIT; and within each, separate for each foreign country-6(b)

126(6)(d) If TP income from business in Canada includes interest paid by NRP, and TP paid non-biz tax on it in foreign country, the interest paid/received is “qualifying income” deemed to be income from a source in the foreign country

#### Foreign Income or Profits Tax

Tax is a levy of general application for public purposes enforceable by a gov’tal authority; Tax doesn’t include resource royalties; voluntary contributions to governmental authorities, and payments to acquire specific right or privilege

* Government: gov’t of a state, province or other political subdivision of that country – 6(a)

***Kempe*** – Church tax in Germany was tax

* A tax is a levy, enforceable by law imposed under the authority of a legislature, imposed by a public body and levied for a public purpose

***Nadeau*** – premium for gov’t workers not for public interest, ie generate income for gov’t, therefore not tax

* Tax: enabling statute, amount imposed under authority of legislature, levied by public agency, for a public interest

Meyer – TP screwed up and overpaid US government – Court find for MNR

* TP cannot claim FTC on tax he had no obligation to pay to foreign country under a Treaty; it’s gratuity, and onus on TP to prove otherwise

#### Source of income and deductions

**ITA 4** Profit or loss from a source(s) in a place (a) computed assuming no income/loss except in that place, deduction allowed only applicable to that source; (b) when partly in one place, calculate separately like in (a)

*How to determine the source?*

Employment income – non biz

* place where normally perform related duties; if duties require significant time abroad, may subject to tax in foreign country on a portion of remuneration, usually based on number of days
* Director’s fee where director’s meeting held, commission income where effort expended for purpose of gaining $

Income from property – non biz

* Interest - Usually resident of debtor (ppl in debt)
* Dividend on share from foreign country A, source A, considering treaty & 250(5) deeming Co non- resident in Canada
* Rental of tangible property – real property, where located; other tangible, where property used
* Royalty payment – where right is used or exploited

Capital gain or loss – non biz

* Disposition of real property – geographic location;
* Other capital property – geographic location where sale or disposition took place
* Deemed disposition – Canada, regardless of geographic location
* Stock or bond sold – location of securities or stock exchange where sold, regardless of where issuer’s transfer office is
	+ If not through exchange, other factors

Business income

* Generally place where operations in substance take place;
* If multiple activities, consider separately, unless incidental; If in multiple countries, reasonable allocation

***Interprovincial Pipe Line Co. – 126(6)(d)***

Fact: CanCo borrow money in CAN, immediately lend to US sub, pay withholding tax on interest revenue from sub; MNR wants to include interest expense paid by CanCo in US taxable income to reduce FTC and expense in CAN

Court: find for MNR; income from sources in foreign countries must include all expenses, including expense paid in CAN

Alternative deduction for foreign income or profits taxes – 20(11) & (12), addition to taxable income 110.5

#### Definition and Alternative Deductions for foreign income or profit taxes

**126(7) Definition**

“BIT – business income tax”: portion of income or profit tax paid by TP to foreign gov’t that can reasonably be regarded as in respect to *income from business carried on outside of Canada* in that country, but does not include (a) if other person/partnership received or entitled to receive from that gov’t, (may 20(12))or (b) exempt under tax;

* Country where tax paid and country where biz is can be different
* Can be carried forward or back

FTP(NBIT) = foreign tax paid in respect of non-business income tax

NBIT – non biz income tax is defined as not including BIT; not what’s deductible under 20(11) and 20(12)

It could include

* Individual: up to 15% Foreign income or profits tax in respect of foreign-source income from a property (not real) + all foreign income or profit tax from foreign-source income from real property
* Other TP: all foreign tax on income from property;

Cannot be carried forward or back

***20(11) + 126(7)*** – 15% limit for tax on “income from property” for individuals

INDIVIDUAL TP can claim up to 15% of tax on income from property (0ther than real) under 126(7), the rest can be deducted under 20(11);

Note: other TP can credit full amount under 126(7); real property can be fully credited by all TP;

***20(12) + 126(7)*** deduction in lieu of FTC

Any TP may claim deduction on ***NBI*** in computing income, but that part of FTC will be lost

* Does not apply to tax on income from FA; limited to NBI on income from a biz or property and its source

#### Excess Credit and Relief Measures

Excess Credit can occur if (a) tax rate higher in foreign country; (b) computation different; (c) losses in Canada

**110.5 Additions for foreign tax deductions**

There shall be added to a corporation’s taxable income such amount as Co may claim to the extent that the addition

1. Increases amount deductible by Co under 126(1) or (2), and (b) doesn’t increase other deductible under 125…

Allow corporations to add extra foreign tax credit to its income in order to increase deductible amount

This in turn increases non-capital losses that could be carry forward 20 years and back 3 years – 111(8)

**BIT** – can carry forward 10 years, back 3 years

**NBIT** – excess may be deducted under 20(11) [individual] or 20(12) [any TP]

### Dividends from Foreign Affiliates

**90(1)** Dividend from Non-resident Corporation included in income

In computing income of a TP resident in Canada, there is to be included any amount received by TP any time of the year as/on account or/in lieu of payment of/in satisfaction of, a dividend on a share owned by TP of the capital stock of a non-resident corporation

“Direct Equity Percentage” of a person in a Corporation-A is the highest percentage of any class of shares owned by him/her

“Equity Percentage” of a person in any corporation is the total of- direct + indirect EP

1. The person’s direct EP, and
2. All percentages obtained when Person’s EP in Corporation-B \* Corporation B’s direct EP in Corporation A

Except for purpose of “participating percentage”, (b) read as if reference to “any corporation” were reference to “any corporation other than a corporation resident in Canada

**95(1) “foreign affiliate**” of a TP resident in Canada means a non-resident corporation in which

1. TP’s equity percentage is not less than 1%, and
2. Total equity percentage of TP and related persons of TP not less than 10% (EP of related ppl determined as if EP without reference to EP of any person in the TP or related to TP – avoid double counting them)

full deduction for dividends from FA paid out of exempt surplus – 113(1)(a)

Indirect credit for dividends from FA paid out of taxable surplus under 113(1)(b)&(c)

Full deduction for dividends from FA paid out of pre-acquisition surplus – 113(1)(d)

Reduction in computing adjusted cost base of shares 92(2)

Order of surplus distribution – Regulation 5901

Definition of surplus accounts in Regulation 5907(1)

* Exempt surplus; exempt deficit; exempt earnings; exempt loss; taxable surplus; taxable deficit; taxable earings; taxable loss; net earnings; net loss

Definition of “designated treaty country” Regulation 5907(11)