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International Taxation

David Duff

Spring 2011



###### PART I: INTRODUCTION

# CHAPTER 1: Introduction to Tax treaties

## Scope and Purpose of Tax treaties

There is no international body that imposes income taxes, and there is no international customary law or convention,. Thus, TAX TREATIES are the closest thing to a system of international tax law that exists.

Canada is in over 80 tax treaties

Most important one: with the US

The primary purpose of tax treaties is to promote international trade an investment by removing double taxation

* + Coordinate national tax claims on the basis of personal jurisdiction and territorial jurisdiction
  + While taxes are imposed by domestic law, the contacting parties make concessions through the treaties

## Model treaties

All treaties are patterned on the model conventions developed by the Organization for Economic Cooperation and Development (OECD)

Thus most treaties have a common structure and a high level of conformity

The principles in these treaties provide the basis for the international tax regime

## Legal Effect of Tax Treaties

Create rights and obligations between the contracting states

No legal rights under the agreement

Binding on the parties under international law

If treaties become a part of the domestic law, then they have to force of law in Canada

Ex ITA

* + 250(5) deems a person who would otherwise be a resident not to be a resident if a tiebreaker finds that that person is a resident in another country for the purposes of that treaty
  + 110(1)(f)(i) allows a deduction for computing taxable income for amounts exempt from tax in Canada under a treaty

## Sources

Text (read in the context of the entire treaty)

Domestic law

#### ITCIA 4.1

* + Applies the GAAR to treaties
  + 4.1 Notwithstanding the provisions of a con- vention or the Act giving the convention the force of law in Canada, it is hereby declared that the law of Canada is that section 245 of the Income Tax Act applies to any benefit provided under the convention.

OECD Model and commentaries

CAN/US treaty

* + Technical explanation by the US treasury department (the CRA agrees with this explanation)

Case law

Scholarly writing / policy writing

## Principles of Interpretation

#### The Vienna Convention Articles 31& 32

contain general rules of treaty interpretation

Article 31: General rule of Interpretation

* + 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 the light of its object and purpose.  
    2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
    - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
    - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
  + 3. There shall be taken into account, together with the context:
    - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
    - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
    - (c) any relevant rules of international law applicable in the relations between the parties.
  + 4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32: Authorizes Supplementary Means of Interpretation (or extrinsic evidence)

* + Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
    - (a) leaves the meaning ambiguous or obscure; or
    - (b) leads to a result which is manifestly absurd or unreasonable.

Article 33 says that when there are 2 or more languages in a treaty they are equally authoritative

This leaves us with 2 Key Elements in Treaty Interpretation

* + The test of the treaty or the ordinary meaning of the terms considered in their context
  + The object and purpose of the treaty

## Definitions and Undefined Terms

#### OECD Article 3(2)

establishes a hierarchy of interpretation rules that apply to treaty terms

“2. any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State”

* + if a term is not defined by the treaty
  + then it is given the meaning of the TAX LAW AT THE TIME in the state (ambulatory rule) above the meaning of other domestic law
    - **Ambulatory Rule:** the meaning of the term is derived from domestic law at the time of applying the treaty (as opposed to time treaty was closed- static approach)

In Canada: Ambulatory Rule is codified in s3 of the ITCIA as a response to…

|  |
| --- |
| R v Melford Developments Inc [1982] SCJ |
| Facts: TP originally assessed on the basis that they had failed to pay non resident withholding tax on guarantee fees paid to a German bank. Canada and Germany had a 1956 tax convention, but an 1974 amendment to the ITA deemed guarantee fees to be interest for the purpose of the non-resident withholding tax |
| Held: for TP |
| Treaty required a static definition because an ambulatory definition would necessarily constitute a treaty override |
| Parliament has the right to override the provisions of the tax treaty, but they must expressly do so  **OVERRULED BY ITCIA ART. 3 BELOW!!!!** |

#### ITCIA Article 3 (Income Tax Conventinos Interpretations Act)

(codification of Ambulatory Rule)

3. Notwithstanding the provisions of a con- vention or the Act giving the convention the force of law in Canada, it is hereby declared that the law of Canada is that, to the extent that a term in the convention is

* + (a) not defined in the convention, (b) not fully defined in the convention, or
  + (c) to be defined by reference to the laws of Canada,
  + that term has, except to the extent that the con- text otherwise requires, the meaning it has for the purposes of the Income Tax Act, as amend- ed from time to time, and not the meaning it had for the purposes of the Income Tax Act on the date the convention was entered into or giv- en the force of law in Canada if, after that date, its meaning for the purposes of the Income Tax Act has changed.

|  |
| --- |
| Gladden Estate v MNR [1985] 1 CTC 163, 85 DTC 5188 (FCTD) |
| Facts: US citizen / resident died in the US, owned shares in two CCPCs . CG was reported on the the basis of a deemed disposition of the shares pursuant to 70(5)(a) ITA. The TP estate claimed exemption under Article VII Can-US treaty |
| Article VIII 1942 Can-US Convention and Protocol |
| gains derived in one of the contracting states from the sale or exchange of capital assets…shall be exempt from taxation in the former state |
| 70(5)(a) ITA |
| Depreciation and other capital property of the deceased TP |
| * + (a) the TP shall be deemed to have disposed, immediately before his death, of each property owned by him at that time that was a capital property of the TP …and to have received proceeds of disposition therefor equal to the FMV of the property at that time |
| Issue: Is the deemed disposition subject to CG tax? Or is it exempted under the treaty? |
| Held: for TP |
| RA’s arguments |
| * + 1) Intention: the treaty was entered in 1942 and there was no CG tax at that time, so it IS taxable (its not in the treaty) |
| * + - TCC accepts this argument – Can had no CG tax and thus it was not an is not bound by the article “the parties could not have negotiated to avoid double taxation on a tax that did not exist in Can” |
| * + - FCA rejects- CG was possible to anticipate, and it is “trite law” to contract in anticipation of events |
| * + 2) Wording – statute says “sale or exchange” and this was a deemed disposition |
| * + - Court looks at Article 32 of the Vienna Convention, which allows supplementary means of interpretation when interpretation according to Article 31 leads to a result that is manifestly absurd or unreasonable |
| * + - Would be absurd to exempt CG for sales, but not a Deemed Disposition (had TP sold right before death, exempt. But DD right after not?) |

|  |
| --- |
| Crown Forest Industries Ltd v Canada [1995] 2 CTC 64, 95 DTC 5389 SCC |
| Facts: Crown Forest (Can) rented barges from Norsk Pacific, a company incorp’d in the Bahamas (tax haven). NP’s. only offices/employees in US. Np filed tax returns in the US as a foreign corp (but exempt as a foreign-incorporated shipping company) CF withheld 10 % tax on the rental payments , on the grounds that NP was a res of US (would be 25% if res of Bahamas). |
| Can-US ITC 1980 Article IV |
| 1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature, but in the case of an estate or trust, only to the extent that income derived by such estate or trust is liable to tax in that State, either in its hands or in the hands of its beneficiaries |
| Issue: Is N a resident of the US for the purposes of the Can-US treaty? |
| Held: for RA (Norsk is resident of Bahamas and not subject to lower withholding tax under the Can-US treaty) |
| * Norsk ‘s Arguments : |
| * + 1) Place of management (only office in US) |
| * + - Lower courts accepted |
| * + - Rejected- “ liable to tax for reason therin” … BY ONE OF THE LISTED GROUNDS |
| * + - * Norsk is taxable in the US on a source basis, because the income flowing from the business it conducted was connected to the US, not b/c of management per se |
| * + - * Place of management is one step removed from the immediate basis for tax liability |
| * + 2) Other Criteria of Similar nature |
| * + - if TP could show “engaged in a business in the US” similar to enumerated grounds then could be deemed a resident |
| * + - however, this is just another basis for source liability |
| * Court: |
| * + Plain language (this is how they rejected Norsk’s arguments)     - NP not taxable “by reason of” place of management. Taxable by US because of attraction rule (earning income through US office), then exempt b/c of for. Incorp. Shipping co. |
| * + Intention of the Drafters |
| * + - Here it is used to confirm the conclusion the court had already arrived at by using a plain language interpretation to reject Norsk’s arguments. |
| * + - Purpose of the treaty: to avoid double taxation |
| * + - * That is not happening here |
| * + - US-Can treaty not meant to benefit corps of 3rd party states |
| * + - No reason that entities not regarded as residents by the K’ing state be resident for the purposes of the convention |
| * + - Resident is someone who is subject to tax on their worldwide income in that state |

#### OECD Article 4

Used as extrinsic material

“Resident of the K’ing state” does not include any person who is liable to tax in that state in respect only of income from sources in that State or capital situated therin



# CHAPTER 2: Residence

## Individual Residence : Domestic Rules

Persons tax liability is based on their status as a resident or non resident of Canada

##### Non residents

* subject to tax only on income from sources within Canada

#### ITA 2(3)

2(3) Where a person who is not taxable under subsection 2(1) for a taxation year

* + (*a*) was employed in Canada,
  + (*b*) carried on a business in Canada, or
  + (*c*) disposed of a taxable Canadian property,

at any time in the year or a previous year, an income tax shall be paid, as required by this Act, on the person’s taxable income earned in Canada for the year determined in accordance with Division D.

#### ITA 115

Non Residents Taxable income in Canada

(1) For the purposes of this Act, the taxable income earned in Canada for a taxation year of a person who at no time in the year is resident in Canada is the amount, if any, by which the amount that would be the non-resident person’s income for the year under section 3 if…. (really long provision)

##### Resident for part of a year:

subject to worldwide income while a resident; during other part of year only source based income is taxable

#### ITA 114

Income = worldwide income for the part of the year when resident + source income for the part of the year when not resident

##### Resident

taxed on worldwide income, and has access to tax treaties

#### ITA 2(1) &2(2)

2(1) An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in the year

2(2) The taxable income of a taxpayer for a taxation year is the taxpayer’s income for the year plus the additions and minus the deductions permitted by Division C.

##### Who is resident? Three essential determinations:

**1) FACTUAL RESIDENT:** CL notion of resident, deemed to include a person who is “ordinarily resident” (s. 250(3))

no actual definition of “resident” in the ITA 🡪 ∴ uses CL test, with inclusion of s.250(3) “Ordinary Resident”

#### CRA Interpretive Bulletin (2002)

courts have held to be “a matter of degree to which a person in mind and fact settles into or maintains or centralized his ordinary mode of living with its accessories, in social relations, interests and conveniences at or in the place in question”

#### ITA 250(3)

provides that in the Act, a reference to a person “resident” in Canada includes a person who is “ordinary resident” in Canada.

* + Ordinary resident: place where the individual, within the settled routine of his life regularly, normally or customarily lives (Thomson v MNR , 1946)

An individual who is ordinarily resident in Canada is determined to be factually resident in Canada

Where an individual is determined not to be factually resident in Canada, they can be deemed by …

##### Persons Leaving Canada

#### ITA 250(3)

“reference to a person resident in Canada includes a person who was at the relevant time ordinarily resident in Canada “

* + courts have relied on this provision in finding that individuals who were “ordinarily residents” in Canada retained their residence even during a temporary absence lasting for the full taxation year or longer

**2) Deemed Resident:** s.250(1) deems certain people residents (can’t be deemed resident if factually resident)

#### ITA 250(1)

A person shall , subject to (2) be deemed to have been resident in Canada throughout the taxation year if the person

* + (a) sojourned in Canada for a period of, or a total of 183 days or more
  + (b) was at any time in the year a member of the Canadian armed forces
  + (c) was at any time in the year and ambassador, minister officer or servant of Canada (i) or a province(ii)
  + (d) performed services for Canada under a prescribed international development program of the Government of Canada , and was a resident at any time in the preceeding 3 months
  + (f) children of any person who is caught by b,c,d
  + (g) was at any time in the year exempted from source taxation in another country on the basis that that person was related to or a member of a family that was a resident in Canada

##### Sojourners

* individuals who do not maintain the necessary residential ties with Canada may be taxed as residents

#### ITA 250(1)(a)

says a person will be deemed to be a resident if

* + (a) sojourned in Canada for a period of , or periods the total of which is, 183 days or more

sojourn (as defined in *Thomson*) means

* + “unusual, casual or intermittent visits or stays”
  + someone physically present in Canada but does not regard Canada as “home” or intend to remain in Canada

#### **3) deemed Non-residents:** not a resident if resident of another person under a TT

#### ITA 250(5)

Person is deemed not to be resident in Canada at a time if, at that time, the person would be a resident in Canada but under a tax treaty with another country is resident in the other country and not resident in Canada

## Individual Residence: Treaty Rules

|  |
| --- |
| OECD 4 |
| 1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. |
| 2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows: |
| * + (a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests); |
| * + (b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode; if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national; |
| * + (c) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement. |
| * + (d) Where by reason of the provisions of paragraph 1 a person other than an |
| 3. individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated. |

Summary: OECD Art. 4(2) contains Tie Breaker Rules:

1. permanent home
2. centre of vital interests
3. habitual abode
4. national/citizen
5. competent authorities can decide (essentially, the courts can toss a coin…)

## Factors considered in determining Individual Residence

Dwelling place

Spouse or common law partner

Dependents

Secondary residential ties (from *Thomson*)

* + Personal property in CAN
  + Social ties with CAN
  + Economic ties with CAN
  + Landed immigrant status or appropriate work permits
  + Hospitalization and medical insurance coverage from province or territory in CAN
  + CAN drivers liscence
  + CAN vehicle registration
  + Seasonal dwelling place/ leased dwelling place
  + A Canadian passport
  + Memberships in CAN unions or professional organizations
  + CAN mailing address, PO box, safety deposit box, business cards

\*\*\* NOTE \*\*\*

CRA General Rule is that you can go away for up to 2 years and still be considered a n ordinary resident of Canada

|  |
| --- |
| Thomson v MNR [1946] CTC 51, 2 DTC 812 (SCC) Facts: TP lived in NB, gets in a fight with the tax authorities and leaves Canada announcing intent to be resident in Bermuda. Does a bunch of travelling and builds a residence in North Carolina in 1930. In 1932, he built a house in NB so that his wife could visit her relatives and he could golf. He never stays in Can more than 169 days in a year, but the house is always accessible to him. MNR tells him to file a tax return, he refuses. |
| Issue: is the TP a resident in Canada and thus liable for income tax? |
| Held:for MNR |
| TP’s argues he’s sojourning |
| * + Sojourning as defined in 250 (1)(a) (never over 183 days) |
| * + - Rejected: “One sojourns at a place where he unusually, casually or intermittently visits or stays” , “ the time of 183 days does not determine whether the party sojourns or not but merely determines whether the tax shall be payable or not by one who sojourns” |
| Ordinary resident: in the place where in the settled routine of his life he regularly, normally or customarily lives   * + - Extended, regular order of life, adopted voluntarily and for a settled purpose.     - CUSTOMARY, SETTLED ROUTINE |
| Court: TP is an ‘ordinary resident’ of Canada |
| * + Born in Canada, has a house, family ties, owns a house that is kept ready and available for him at any time   + There was regular routine in his life here, and it is “well established that a person may have more than one residence “ (everyone has one, but nothing to say you can’t have more than one) |
| * + Here, the TP’s living in Canada is a substantially as deep rooted and settled as in the United States |
| ~~DISSENT~~ |
| * + ~~Draws a distinction between “ordinary resident” and “residing”~~ |
| * + - ~~OR: those who have their permanent home and settled abode~~ |
| * + - ~~R: those who live here most of the time, absent on temporary occasions~~ |
| * + ~~Thinks Thompson should have been considered a resident of the US, occasionally visiting Canada~~ |
| \*\*NOTE: So Thompson ended up being doubly taxed here… largely because he pissed off the court… now this would be sorted out with a TREATY\*\* |
| * + If we applied something like OECD 4(2) |
| * + - His family ties could make it seem that his center of vital interests is in CAN |
| * + - Seems to fulfill all the others equally so would end up with a competent authority scenario |

|  |
| --- |
| The Queen v Reeder [1975] CTC 256, 75 DTC 5160 (FCTD) |
| TP Canadian, took a job K in France ~6mo, tried to claim not res. of Can during that time.    While in France, TP had bank account in Can, furniture and care were stored in Can . Michelin France covered his costs while in France . TP’s wife was in France (and kid was born there) but the rest of his family was in Canada. TP was in France from March to December, 1972 . TP tries to file with reduced tax liability under ITA 114, MNR argues he was ordinary resident the entire time as per ITA 250(3) |
| **Issue**: should the TP be taxed as a resident for the entire time? |
| **Held**: for MNR - TP caught by extended def’n of resident (ie. “ordinarily resident” in Can) |
| Factors Considered |
| * + Past and present habits of life |
| * + Regularity and length of visits to place asserting residence |
| * + Ties within that jurisdiction |
| * + Ties elsewhere |
| * + Permanence or otherwise of purposes of stay abroad |
| “The matter of ties within the jurisdiction asserting resident and elsewhere runs tha gamut of the individuals connections and commitments: property and investment, employment, family, business, cultural and social are examples, again not purporting to be exhaustive. Not all factors will necessarily be material to every case. They must be considered in the light of the basic premises that everyone must have a fiscal residence somewhere and it is quite possible for an individual to simultaneously be resident in two places for tax purposes” |
| in the TP’s circs, all ties were in Canada, save those that were necessary for him and his family to enjoy an acceptable lifestyle in France |
| * + if TP had been asked where he lived while in france, he would have said Canada   **\*\*CRA Policy: if <2yrs, still res of Canada\*\*** |

|  |
| --- |
| Schujahn v MNR [1962] CTC 364 (Exch Ct) |
| TP US citizen, employee of GM in the US. GM wants to set up TO office, sends the TP there to set it up. He moves there in 1954, family goes with him, he buys a house and has small bank accounts and (most important!) cancelled all his club memberships in US in exchange for Can ones.  TP is recalled August 2nd 1957 to the US. He goes back right away (staying in hotels), but leaves family behind (said easier to sell a house when it is occupied). He also (again important!) switches his Can. Club memberships for US ones. He visits TO briefly 3 times while his wife still lives there. When house is sold in 1958 his wife and son move back to the states and they buy a house there. |
| Issue: did the TP remain a resident of Canada after August 2nd 1957? |
| Held: for TP |
| TP says ceased to be a resident, court agrees   * + Factors:     - Job moved out of Can     - Resident in US before     - Family only left behind b/c trouble selling house (same with bank accounts)     - Cancelled Can club memberships, renewed his US ones. |
| visits to CAN were of transitory and incidental nature |
| court looks at original residence |
| * + the TP moved back to the same city in the US, this might have helped his case (seems that once a resident of somewhere, easy to become resident again) |

|  |
| --- |
| Lee v MNR [1990] 1 CTC 2082 (TCC) |
| TP has a UK passport, is from England. Entered Canada a bunch of times, his passport was stamped with visitor each time. He was employed by a non resident corp and all work was done outside of Canada. All his income went to a Canadian bank account. In 1981 the TP married a Canadian citizen, who had none of her own income and was wholly dependent on the TP. Wife bought home with the TP’s money, TP guaranteed the loan by swearing he was a Can resident (sept 1982). MNR reassess on the basis he was resident from 81-83 |
| Issue: when did the TP become a CAN resident? |
| Held: TP appeal allowed in part |
| court holds that the TP became a Can resident when he was married |
| * + while marriage can be a neutral factor, here it shifts the scales |
| non resident up until date of marriage, resident after |

## Corporate Residence

resident corporation is subject to Canadian tax on its worldwide income, while a non-resident corporation is taxed only on income derived from Canadian investment or business.

Common Law (Central Management and Control test):

\*\* NOTE: DEEMING RULES ONLY REFINE CORP. RESIDENCE TEST (central mg’t and control test)

*DeBeers Consolidated Mines Limited v Howe (1906)):* CENTRAL MANAGEMENT TEST

the place where a company resides is where its real business is carried on and where the central management and control actually abides

in general, the place of central management and control is where the directors of the corporation meet and exercise control

##### Domestic Rules

ITA has a STATUTORY PLACE OF INCORPORATION TEST

#### ITA 250 (4) – deemed residence

Corporation shall be deemed to be a resident in Canada if ;

* + (a) it was **incorporated in Canada** (after April 26 1965)
  + (c) it was incorporated in Canada before April 27 1965 and:
    - at any time after was resident in Canada (CL test)
    - OR CoB in Canada

#### ITA 250 (5.1) – continuing into other jursid.

If a corporation is incorporated in one jurisdiction and granted articles of **continuance** into another the corporation is deemed to have been incorporated in there at the time of continuance

#### ITA 250 (6)

A corporation that has a principle business of shipping and is resident of the place where it was incorporated (if they follow the rules articulated in the ITA)

* + Not based on Central Management and Control test

##### Treaty Rules

#### OECD Art 4(1)

* For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

#### OECD Art 4(3) –TIE BREAKER RULE

Where by reason of the provisions of paragraph 1 a **person other than an individual** is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its **place of effective management is situated.**

* + TIEBREAKER RULE: place of effective management and control

#### CAN-US Art IV

(1) Residence means any person that, under the laws of the that state, is liable to tax therin by reason of that persons domicile, residence, citizenship, place of management, place of incorporation or any other criterion of a similar nature…

(3) where by reason of the provisions in para (1) a company is a resident of both Contracting States then

* + (a) if it created under the laws in force in a contracting state, but not under the laws of the other then it shall be deemed a resident only of the first mentioned state
    - PLACE OF INCORPORATION
  + (b) in any other case, the competent authorities shall endeavor to settle the question of residency by mutual agreement, in the absence of such agreement then the company shall not be considered a resident of either contracting state for the purposes of claiming benefits under this convention
    - COMPETENT AUTHORITY

#### CAN-UK Article 4

(3) where a person other than an individual is a resident of both Contracting States, the competent authorities of the contracting states shall endeavor to determine by mutual agreement the state of which the person shall be deemed to be a resident, having regard to its place of effective management, the palce where it was incorporated or otherwise constituted and any other relevant factors . If the competent authorities are unable to to determine the matter by mutual agreement, they shall endeavor to determine by mutual agreement the mode of application nto the convention

|  |
| --- |
| BC Electric Railway v The Queen [1945] CTC (Exch Ct) |
| The TP company paid dividends to non residents of Canada and didn’t withhold tax. Reasses on the basis that they are a CAN resident and thus should have. TP was incorp in the UK, has always had its registered office and kept its register of members in respect of its preferred stock in London. It was registered in BC as an extra provincial company, carries on the business of supplying electric power and light an operating electric railways and busses in BC, and has a head office in Vancouver. During time under review all business (other than administrative tasks) took place in Can, all D&O’s were residents of Canada, all D’s meetings in Canada, all assets in can, all income from which dividends were declared was earned in Canada, and dividends were declared at a meeting in CAN |
| Issue: is TP a resident of CAN? |
| Held: for RA |
| applies *DeBeers Consolidated Mines Limited v Howe* |
| * + the test of residence is not where it is registered, but where it really keeps house and does its real business, and that real business is carried on where the central management and control actually abides |
| * + CENTRAL MANAGEMENT TEST |

|  |
| --- |
| TD Securities (USA) LLC v The Queen 2010 DTC 3208 TCC |
| LLC is a “fiscal transparency,” a flow-through entity (ie. Not a corporation) whose income is attributed to its “members” (ie. Parent). However no such entity exists in Can. Law, so it must be treated as a corp. LCC is a res of US, but has a branch in Canada (which satisfies PE test). Wants to pay the reduced treaty branch tax (5%) rather than the general (25%) rate. MNR refuses, saying that to be eligible it must be “liable to tax in the US.” It isn’t, since its Parent is the one actually liable to tax. TP says this doesn’t matter, as the parent is still paying full US tax for its income.  **Issue**: is TD LLC able to access the treaty-rate branch tax, or must it use the higher non-treaty rate? |
| TD bank ( Can) – TD USA (US)- Holding co (US)- TD LLC ( can/us???) |
|  |
| CAN-US IV(6) |
| X(Can) -> y (fiscally transparent, not in Can) -> z (person who is taxed, in US) |
| * + Says income shall be considered derived from z , where the TP is considered under the law of that state not to be resident of the other state |
| * + - Need y NOT to be in Can, and to be fiscally transparent |
| CAN-US IV (7) |
| (a) |
| * + x (Can, not transparent) -> y ( not US, not fiscally transparent) -> z ( US) |
| * + - if x is not transparent and not in the US, then income attributed to z |
| (b) |
| * + x (Can considers not resident, US coniders fiscally transparent) -> y -> z |
| * + - considered derived in Can |
| So neither of these provisions is particularly helpful to the facts of this case |
| Held: for TP |
| * doesn’t want Canadians escaping tax by rooting in the US, but here the income is being fully taxed by the US through the holdings company |
| * + it was not intended that that an entity whose income was being fully and comprehensively taxed in the other contracting state would be denied benefit of treaty because it was being taxed in the other state at a different level (ie. By the member, rather than the entity itself) |
| * + the income is being taxed here, the problem is because TD LLC is not the one being taxed |
| * + if the Canadian sourced income was not subject to treaty benefits **it would frustrate the treaty**   + therefore, treaty should be read in light of its full context, with the benefit of the OECD model and its commentaries that say it should get access to treaty in this case     - OECD model commentary agrees that transparencies aren’t subject to tax, but that they should get the treaty benefits anyways. |
|  |

## Residence of a Trust

#### ITA 94

Deals with application of certain provisions to trusts NOT resident in Canada

#### ITA 104(1)

Deals with trusts and their beneficiaries

ITA does not have a provision determining residence of trust

#### CRA interpretive bulletin IT-447

May 30th 1980- AFTER Thibodeau, but sets context for Garron

* + “normally residence fo a trust is dependent upon residence of the trustee or trustees who can exercise management and control of the trust. In some situations the facts may indicate that a substantial portion of the management and control rests with some other person such as the settlor or the beneficiaries. In these situations the residence of this other person may be considered to be the determining factor for the trust regardless of any contrary provisions in the trust agreement”

|  |
| --- |
| Thibodeau Family Trust v The Queen [1978] DTC 6376 (FCTD) |
| 3 trustees of the TF trust, 2 in Bermuda, 1 in Canada. Trust was established for the benefit of the Can trustee and he was active and influentialTrust realized gain on sale of shares. TP paid withholding tax of 15% on the premise that trust was non-resident and income tax on the gain on the premise that it was the sale TCP by a non resident. MNR said was resident of Bermuda |
| Issue: is the Trust Resident of Canada? |
| Held: for MNR |
| CRA argues that the central management and control test mean Bermuda |
| * + Majority of trustees could make decisions binding on the trust |
| * + Day to day admin was carried out in Bermuda |
| * + Did not always follow wishes of the Canadian trustee |
| * + Meetings were held in bermuda |
| TP argues that you can apply the same residence principles to a company as to a trust |
| * + One trustee was a can resident |
| * + That trustee was the one with the power to appoint other trustees |
| * + That trustee took an active interest, was CEO, handled bank accounts, etc etc etc |
| Court: says that it cannot accept the TP;s proposition that if they find a residence in Bermuda they also must find one in Canada.  “The judicial formula for this respecting a corporation, in my view, cannot apply to trustees because trustees because trustess cannot delegate their authority to co-trustee… therefore it is not possible for a trust to have dual residence for income tax purposes, and therefore it is not possible to find that part of the paramount of of “superior and directing authority” of a trust is in two places. In any event, a finding of dual trust is not made in this case” |
| * + Note that Garron does not interpret this to meant the residence of a trust can NEVER be determined on the basis of the place where its central management and control is exercises and must be determined exclusively on the basis of the residence of the trustee   **RATIO: Trust is resident WHERE ITS TRUSTEES are resident (as mg’t of a trust can’t legally be delegated)** |

|  |
| --- |
| Garron Family Trust 2010 FCA 309 |
| Garron |
| | |
| PMPL Holdings |
| / \ |
| PMPI PTL |
|  |
| Then… in the mid 90’s RESTRUCTURE |
|  |
|  |
|  |
| (Canada) (Canada) |
| (barbados) trust Garron AD trust (Barbados) |
| \ | | / |
| Garron Holdings (50%) Dunnin Holdings (50%) |
| \ / |
| PMPL |
|  |
| Restructure: estate freeze transaction, growth shares xferred to Barbados trust (offshoring future CG) |
| Steps of the Restructure |
| 1. set up DH / GH |
| 1. set up 2 trusts , 100$ in each of them |
| * + shares can be sold and distribute cash, but you cannot distribute shares |
| * + trusts managed exclusively in barbados |
| 1. loan from the protector to the trust |
| * + repayable on the sale of shares |
| * + used to capitalize |
| 1. holding companies get freeze shares in exchange for their common shares |
|  |
| Now… purchaser approaches |
| 1. offer for 400 million |
| 1. another offer for 532 million (hence valuation issue) |
| 1. Garron sells out for 217 million |
| 1. Dunnin sells 90.7% of shares for 240 million |
| 1. Shareholders of GH sell out for 25 million (frozen) |
| 1. Shareholders of Dh exchange for shares in the new company |
|  |
| Issue: where were the trusts resident?   * Barbados treaty exempts residents from Can CG (and doesn’t tax CG itself, meaning TP would escape tax) |
| Held: for MNR |
| TP said that residence is based on the residence of the trustees, and that this is a legal relationship |
| * + Trust is legal relationship without separate legal personality |
| Court interprets Thibodeau differently, says residence is a FACTUAL DETERMINATION |
| * + Goes to the central management and control test   + (says that TP’s argument isn’t what Thibodeau stands for, and if it is then its wrong) |
| Here, Garron and Dennin were running the trusts, as they could replace the protector who could replace the trustee |
| Key issue in determining residence in trusts: who is REALLY in control of management? Is it actually the trustee? |

|  |
| --- |
| Antle v Queen [2010] FCA 280 |
|  |
| MI MK A |
| (wants to buy PM) \ / | |
| PM <- S \*\* S gives preferred shares, get right to 50% of the gain if they sell\*\* |
| | -> |
|  |
| SCC |
|  |
|  |
| S willing to take 3 million dollars |
| If MK and A sell they will have to pay large CG tax  Solution: freeze Xact with “capital step-up strategy,” and gains offshored to Barbados |
| Create a “capital property step up strategy” |
| * + gift the shares to to the trust |
| * + - 73(1)(c) rollover on a spousal trust when the transferor and the transferee are resident in Canada |
| * + - * but, want the trust to be NOT resident |
| * + - 94(1)(c ) a discretionary trust (non resident) that benefits a resident is deemed a resident |
| * + - * thus trust is resident for purpose of 73(1), even though actually resident of barbados |
| * + - so Trust is NOT resident, but is deemed one for part I ( s 73) and not the treaty (s 250(5))       * treaty exempts Barbados resident trusts from Can tax (ignores deemed Can res.) |
| * + trust sells shares to wife at FMV (promissory note) |
| * + - CG not taxable in Barbados |
| * + Trust is wound up and the property goes to the spouse |
| * + the wife sells to MI (no gain, the cost was the same as FMV) |
| * + then the wife gives the $ to the spouse |
|  |
| Then… MNR gets mad and calls the trust a sham, wants to tax the CG |
| Issue: was there a legitimate trust ? Does the GAAR apply? |
| Held: for MNR |
|  |
| Court holds that this is was even a trust |
| * + Antle never intended the shares to go to the trustee, just to avoid tax |
| * + Doctrine of ineffective transactions |
| * + - Didn’t actually make a trust, at best it was an agent |
| * + - Never transferred all the rights and interests in shares |
| * + “ in short, if you are going to play the avoidance game, it is not enough to have brilliant strategy, you must have brilliant execution. I find no trust was duly constituted. The trusts appeal is therefore quashed” |
| IF they had done it properly, GAAR would likely apply |
| * + This is a series, which can be denied under the GAAR |
| * + - Series: a a bunch of transactions that are likely to be carried out |
| * + Obvious tax benefit |
| * + Obvious and conceded tax motivation |
| * + GAAR applies to treaties (245(4) ITA and ITCIA 4.1) |
| * + - TP argues that the treaty with Barbados was before the ITA and the ITCIA were amended to include the GAAR, so they should not apply |
| * + - * In many cases, Canada has enacted legislation that ensures that the ITCIA overrides reties in the even of conflict, but they have not doen that for the Barbados treaty, so the TP.. |
| * + - * Cites 26(2) which says that in the case of an inconsistency, the provisions of the treaty prevail |
| * + - Court applies ambulatory principle, and the later amendments are clear so they trump the earlier treaty |
| * + - Setting up the Barbados trust not in itself abuse |
| * + - * The abuse is in relation to the domestic rules (73(1)(c) spousal rollover and 94(1)(c) deeming provision both abused) |
| * + - * “the object, spirit and purpose of the Canadian legislation as it pertains to a Canadian resident is not to be swept aside because of the policy of the treaty , as pertaining to a non resident trust, might save the trust, especially when one considered an overarching policy of entering treaties to prevent tax avoidance by Canadian residents “ |
| * + - The treaty might save the spousal trust , but it wont save the Canadian resident from an application of the GAAR |

## Changes of Residence

#### ITA 128.1

128.1(1) Immigration

* + (a) TP is deemed to have commenced a new taxation year
  + (b) When the TP becomes a resident, they are deemed to have disposed of all property other than property that is
    - Taxable Canadian Proprty
    - (other exceptions, but that one is the important one)
  + (c) the TP is deemed to immediately acquire all the properties that they were deemed to have diposed of in (b), at a price equal to the proceeds of disposition

128.1( 4 ) Emigration

* + (a) Tp’s fiscal year end is deemed to have ended immediately prior to leaving
  + (b) TP is deemed to have disposed (at the time of disposition – pretty much when they leave) of all property that they own (if they are an individual), other than
    - real property in Canada (would be TCP when non resident)
    - For proceeds equal to FMV at the time of disposition
  + (c) TP shall be deemed to have reacquired , at the particular time, each property deemed to have been disposed of in (b) at a cost equal to the proceeds of disposition of the property

purpose of 128.1 is generally to ensure that a migrating TP is subject to tax in Canada only in respect of gains and other income that accrue while the TP is resident in Canada



# CHAPTER 3: Introduction to International Tax Avoidance

Inbound Treaty Shopping:

Funnel money through a conduit state to access treaty benefits

(ie. MIL, moving parent to Lux to take advantage of Can-Lux treaty)

Outbound Treaty Shopping:

Artificially turns Canada into a source country

(ie. Antle, setting up trust in Barbados to offshore CG)

## Treaty Shopping: General Anti Avoidance Rules

#### ITA 245

GAAR

* + Tax benefit 245(3)
  + Tax motivated 245(3)
  + Use or abuse 245(4)

#### ITCIA s 4.1

“nonwithstanding the provisions of a convention of the Act giving the convention the force of law in Canada, it is hereby declared that the law of Canada is that section 245 of the ITA applies to any benefit provided under the convention”

## Treaty Shopping: Anti Avoidance Rules in Tax Treaties

#### CAN-US Art XXIX A – limitation of benefits (LOB) clause

limits the benefits of the treaty to genuine residents in Canada and sets forth a number of test classifying who is a genuine resident

tests are designed to identify people with a substantial connection to Canada

Qualifying persons get benefits

If not qualifying person, then you can get under para 3, 4, 6

* + 3- Active trade or business
  + 4- Derivative Benefits
  + 6- Competent Authorites

Limitation of Benefits

* + (1) resident is not sufficient for benefits to accrue, must be a qualifying person
  + (2) **qualifying person** is a resident PLUS something else …
    - (a) natural person
    - (b) governmental entities
    - (c) publically traded corps
      * company trust or principle class or disproportionate interest with shares **primarily or regularly** traded on a **recognized stock exchange**
        + principle class: common, majority of value and vote
        + no definition of primarily/ regularly traded

use US technical explantion

primarily= more than others (comparative)

regularly= at least 60 days, at least 10% of shares

* + - * + disproportionate interest

capture a class of shares that are held and traded by someone else

also has to be primarily and regularly traded

* + - (d) subsidiaries of a publically traded corporation
      * 5 or few qualifying persons under c which own 50% of votes **and** value of each disproportionate class (directly or indirectly)
        + so make sure it’s a qualifying person and more than 50%
        + applies to whole chain of ownership
    - (e) base erosion test
      * if company or trust is owned at least 50% by qualifying persons and deductible payments to non qualifying persons are less than 50% of the gross income
      * prevents funneling of income to non qualifying persons
    - (f) estate
    - (g) non profit organization provided that at more than half of the members are qualifying persons
    - (h) trusts that benefit qualifying persons
  + (3) **Active Trade or Business:** if you are a resident of the contracting state but not a qualifying person, but engaged in active trade or business that in the other state (other than investing) then the benefits of the treaty apply to the resident in respect to income derived from the other state in connection with or incidental to that trade or business
    - resident
    - not QP
    - engaged in active trade or business
    - in connection with **OR** incidental to:
      * connection – upstream/downstream/parallel
      * incidental – arises from short term investment of capital reserve, doesn’t have to be the same kind of business
    - must be substantial
      * seems open to be litigated, doesn’t have to be bigger, but must not be small percentage (ie. just can’t be “insubstantial”)
    - includes if it comes through a person or a PE
  + (4) company in resident state-
    - Look through/ derivative benefits test
      * If non-QP would get the same benefits from another treaty had they gone directly, LoB won’t apply to deny them
    - If the company is resident and most of its shares are owned by people who are qualifying persons or residents in the other state
      * Not QP
      * No active trade or business
      * more than 90% votes and value **OR** more than 50% of a disproportionate class
      * Owned by a 3rd party that would be QP person if they were resident
      * And the treaty rates are the same

🡺 Then the benefits are conferred

* + (6) if competent authority decides, can be granted benefits of the treaty
    - saving provision
      * no principle purpose to get benefits
      * or would be inappropriate top deny benefits
  + (7) Convention shall not be construed as restricting in any manner the right of the contracting state to deny benefits under the Convention where it can reasonably be construed that that to do otherwise would result in an abuse of the provisions of the convention

#### CAN-UK Treaty 10(7), 11(11), 12(8)

Use the “beneficial ownership” test

10(7) dividends

* + provisions of this article do 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

11(11) Interest

* + provisions of this article do 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 debt-claim in respect of which the interest was paid to take advantage of the this Article by means of that creation or assignment

12(8) Royalties

* + provisions of this article do 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 rights in which the royalties are paid to take advantage of this Article by means of that creation or assignment

## Prevention of Treaty Shopping Through Interpretation

#### OECD Art 1 para 9.3

countries consider that a proper construction of tax conventions allows them to disregard abusive transactions, such as those entered into with a view to obtaining unintended benefits under the provisions of these conventions

#### Vienna Convention Art 31

obligation to interpret treaties in good faith

##### Treaty Shopping Structure

X

\

| C

/

Y

* x and y have no treaty, but x and c have a treaty for little withholding tax
* so corp in x sets up sub in c to take advantage of this

##### Responses to Treaty Shopping

Argue not a resident (Guerin)

Beneficial Ownership (Prevost Car)

Inherent Anti- Abuse principles

|  |
| --- |
| MIL Investments (SA) v The Queen 2007 DTVC 5437 FCA |
| TP gets shares in DFR, transfers shares to MIL. Find a huge diamond deposit, Teck and major players get involved in developing it. Shldrs not willing to sell all, so MIL does a transfer wil INCO so now INCO has shares in DFR and MIL ownership has gone from 11.9% to 9.81% (below the 10% threshold). MIL then continues into Luxembourg, who has an advantageous treaty with CAN. Then the guy who was helping them develop DFR dies, MIL is sold for 437 million (would be a CG< except for the “step up”)   1. TP invests in DFR, transfers shares to Cayman Islands holding co. MIL 2. Huge resource find, Teck get involved and purchase stake in DFR 3. Inco wants to get involved, Inco shares traded as consideration for DFR shares (s.85.1 rollover, so no CG). \*\*MIL’s stake in DFR by now is diluted to <10%\*\* 4. MIL continues into Luxembourg, which has TT with Canada. This “bumps up” ACB of shares to current FMV 5. MIL sells all Inco shares (no CG, as no gain due to bump up) 6. Inco initiates takeover of DFR. MIL cashes out.    1. No Can source tax for CG because MIL owned <10% (did not constitute a “substantial interest,” therefore not taxable in Can, only in lux (who chose not to tax it either)) |
| B |
| | |
| MIL (Caymans -> continues into Lux) |
| / | |
| INCO- ------DFR ------- TECK (10%) |
| \ | |
| VBNC |
| CAN- Lux Art 13(1) , (4) |
| (1) gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other state may be taxed in the other state |
| (4) gains derived by a resident of a Contracting State from the alienation of |
| * + (a) shares forming part of the substantial interest in the capital stock of a company which is a resident of the other contracting state the value of which shares is derived principally from immovable proeerty situated in that other state or |
| * + (b) … a substantial interest exists when the resident and persons related thereto **own 10% or more** of the the shares of any class of the capital stock of the company |
| \*\* note that these exemptions to general rule of resident taxation are not in the OECD model\*\* |
| **Issues:** does the GAAR apply (most important: was it part of a SERIES of xact?)? Is this Inherent Abuse? |
| **Held: for TP** |
| Inherent Anti Abuse - NO |
| * + Vienna Convention 31, art 31 |
| * + - Court says this only binds the parties and MIL was a 3rd party |
| * + - Plus, only in ambiguity do you look to other sources |
| * + 1977 OECD commentary seems to support this view, BUT you must refer to an anti-avoidance provision if you want it to exist |
| * + - Can and Luxembourg both had anti-avoidance rules at this time and there was no effort to include |
| * + - And the treaty was made in 1990 so this commentary existed |
| * + 2003 commentary is different, does talk about anti-avoidance |
| * + - it was dismissed in the case because they interpreted the VC to mean that they could only consider the OECD model at the time the treaty was drafted |
| * + - Duff thinks this is a strong argument |
| * + - Prevost car disagrees |
| * + But, there is no explicit reference to anti-avoidance rules , and no ambiguity |
| **GAAR** |
| * + MNR argues that the exchange of shares to get under 10% and the move to Luxembourg were potentially abusive |
| * + 4.1 ITCIA means that the GAAR will apply regardless of the treaty |
| * + 1) Tax Benefit Benefit |
| * + - Deduction, referrals |
| * + 2) Avoidance Transactions (or Series of transactions ) - BIG ISSUE     - Series at issue:       1. Decrease of DFR share to <10% in exchange for INCO shares (rollover)       2. Continuing into Lux       3. Sale of Inco shares       4. Sale of DFR shares |
| * + - CL says series: preordained all of the transactions (worked for Antle, all in 24 hours in one room) |
| * + - Ordinary meaning : preordained and contemplated |
| * + - Extended definition 248(10) series deemed to include any related transactions completed in contemplation of a series |
| * + - * Meaining of “Contemplated”: |
| * + - * + **prospective view** - Regard as possible – |
| * + - * + **restropective view** - FCA Rothstein says contemplation can include “knowledge of prior series” |
| * + - Court says not preordained (INCO was a takeover bid -> MIL, as a minority s/h, could not have influenced other s/h to execute sale just so that it could avoid tax) |
| * + - * Also not contemplated - Guy dies |
| * + - * + (Duff disagrees- says that an eventual sale could have been contemplated) |
| * + 3) Tax motivated |
| * + - MIL to Luxembourg could have had a bona fide purpose (TP argued Lux good for diamond mining) |
| * + 4) Misuse/abuse |
| * + - The avoidance transaction MUST be the abusive one – they conceded at FCA that the move was tax motivated but that still isn’t enough, as it was the rollover that was abused |
| * + - If they had focused on the abuse of the rollover, then they could have said the purpose of that provision was not to avoid Canadian tax (like in Antle) |
| * + - Treaty says 10%, adhering to it shouldn’t be abusive and court is unwilling to look behind the provisions and find an abuse that was not argued. |

## Non Arms Length Transactions

The ITA includes rules for transfer pricing aimed at

* + Allocating income between related companies
  + Support the arms length principle
  + Avoid companies shifting income away from Canada through transfer pricing

Transfer price received or charged will be included in the income of one company and deducted from the other, so price is crucial to allocation of profit

If tax is lower in Barbados, US or Germany, inflating the price paid and deflating the price received would be beneficial to related corporations

##### The Arms Length Principle

Requires that related enterprises deal with each other on an arms length basis

## NALT Domestic Rules

#### ITA 247 (2)

Where a TP or a partnership or a non-resident person with whom the TP deals with NAL are participants in a series of transactions and

* + (a) the terms of the transaction are different than they would have been between ALP or
  + (b) the NAL transaction would not have been entered between ALP’s (i) and cat not reasonably be considered to have been entered for bona fide business purposes other than to obtain a tax benefit (ii)

then the CRA can adjust any amount that would otherwise have been an amount determined for the purposes of the ITA if

* + (c ) deems the terms that would have been entered if persons were AL (if a applies)
  + (d) deems the transaction had been one entered into between aL parties ( if b applies)

**Summary: 1) if terms used by NAL Δ than if AL, deemed to use AL terms**

**🡪 can recharacterize amounts/nature**

**2) where Xact/series would not have occurred if AL, and not entered for BF bus. purpose, then disallowed and Xact/series ALP would have used deemed instead**

**🡪 can recharacterize/reconceive entire Xact/series**

#### ITA 247(3)

imposes a 10% penalty on adjustments made by the CRA for transfers that were not valued using an appropriate AL method

can only be applied when the TP has not made reasonable efforts to determine AL prices or allocations

#### ITA 69(1) – general NAL rule

deals with inadequate consideration

essentially means that when a TP acquires or disposes of anything for less than FMV or gets a gift or inheritance they are deemed to have acquired it for FMV

(3) existed until 1997

* + when NAL and not reasonable amount- reasonable amount is deemed to be what was paid

*ITA 17(1)*

amount owing by a non resident

when a non resident owes an amount to a resident corporation, and has been or remain outstanding for more than a year then interest or other amounts that would be reasonably attributed are included in the corporation interes

## NALT Treaty Rules

#### OECD Art 9

1. Where

* + a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
  + b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,
  + and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions,have not so accrued, may be included in the profits of that enterprise and taxed accordingly.
  + **Summary: profits that would have occurred in a country if parties AL deemed to occur there for taxation.**

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

#### CAN-US Art IX

1. Where a person in a Contracting State and a person in the other Contracting State are related and where the arrangements between them differ from those which would be made between unrelated persons, each State may adjust the amount of the income, loss or tax payable to reflect the income, deductions, credits or allowances which would, but for those arrangements, have been taken into account in computing such income, loss or tax.

2. For the purposes of this Article, a person shall be deemed to be related to another person if either person participates directly or indirectly in the management or control of the other, or if any third person or persons participate directly or indirectly in the management or control of both.

3. Where an adjustment is made or to be made by a Contracting State in accordance with paragraph 1, the other Contracting State shall (notwithstanding any time or procedural limitations in the domestic law of that other State) make a corresponding adjustment to the income, loss or tax of the related person in that other State if:

* + (a) It agrees with the first-mentioned adjustment; and
  + (b) Within six years from the end of the taxable year to which the first-mentioned adjustment relates, the competent authority of the other State has been notified of the first- mentioned adjustment.

4. In the event that the notification referred to in paragraph 3 is not given within the time period referred to therein, and if the person to whom the first-mentioned adjustment relates has not received, at least six months prior to the expiration of such time period, notification of such adjustment from the Contracting State which has made or is to make such adjustment that State shall, notwithstanding the provisions of paragraph 1, not make the first-mentioned adjustment to the extent that such adjustment would give rise to double taxation.

5. The provisions of paragraphs 3 and 4 shall not apply in the case of fraud, willful default or neglect or gross negligence.

#### CAN-UK Art 9

(1) Where

* + (a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
  + (b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any income, deductions, receipts or outgoings, which would, but for those conditions, have been attributed to one of the enterprises, but, by reason of those conditions, have not been so attributed may be taken into account in computing the profits or losses of that enterprise and taxed accordingly.

## Transfer Pricing Methods

“Arms length principle” -> what would be charged if parties were AL? Meant to distribute tax revenue fairly between jurisdictions

The CRA position is generally based on the OECD Transfer pricing guidelines (really just an FMV test)

* + h/e FMV test is contentious: hard to properly price intermediate goods / goods where no market price available for comparison

First 3 are “traditional”, last 2 are “profit split” methods

##### traditional methods:

##### Comparable Uncontrolled Price (CUP)

TEST: Is there a comparable market price?

* + Works for simple products.

Strict comparability

Used where there is a comparable NAL product being bought or sold in similar quantities in and under similar terms within similar markets

* + Requires strict comparability (must be almost identical products)
  + Judges seem to prefer this method (think it’s the most realistic), and are hesitant to move past it

##### Resale Price

TP can subtract a gross profit mark up from the price that would have been sold to unrelated parties

Used when the related part adds relatively little value to the goods

##### Cost Plus

TP adds an appropriate profit percentage or mark-up to its costs of producing the product or service prior to a sale of a related party

Used where the related party purchases a good and adds value to it prior to resale

**Non-traditional:**

##### Profit Spilt

Split how much you made between the two companies in proportion to the contribution

* + Use some sort of proxy (ie. Payroll, inventory) to determine where value is being added

##### Transactional Net Margin Method (TNMM)

Similar to cost+ and resale price

* + Look at net margin
  + Apply to purchase or sales
  + Go straight to profit 🡪 don’t look at particular things (?)
  + Can do braoder comparisons b/w whole industries

Typically only applied to one participant

Compares net profit margins

Can be used for broader comparisons (ie luxury goods rather than just perfume)

Advanced Pricing Agreements (APAs)

\*\* prob don’t need to know??? \*\*

\*\* TP’s generally try and use CUP, while the RA are trying to get at synergy costs using the latter 2 \*\*

|  |
| --- |
| Glaxosmithkline v Queen 2010 DTC 7053 FCA |
| GLaxo had the Zantac brand name , which allowed them to sell their drug at a substantial premium. The active ingredient, Ranitidine is available from other manufacturers for cheaper, but G buys their R from NAL company Adesha ( in Switzerland) for 1500-1600 a kilo (generics paying 194-304). They also have a licensing agreement with Glaxo Group. Glaxo applied the resale price method, which was based on the ultimate shelf price and involved a 60% markup. MNR reassessed using 69(2) and says they should use the price as if dealing at arms length (ie for the generic R) , and says if they are paying this much then part of it is a dividend and should be subject to withholding tax |
| Issue: what is the appropriate pricing method? |
| TC: finds for RA |
| All agree CUP should be used , but allows a slight markup because their R was granulated |
| TP said generics aren’t an appropriate comparison ( because of different business circumstances) and the R is fundamentally different due to Glaxo manufacturing standards |
| FCA: holds for TP |
| TP argues you must look at the circumstances of the deal (69(2) says reasonable in the circumstances) |
| * + TJ didn’t consider the license agreement – in order to use Zantac they have to buy from Adesha |
| * + They have to buy the Adesha R, as it is part of their marketing strategy |
| * + - These circumstances would have been present even if the TP had been arms length |
| Court agrees with this: states there is no fictitious business world and the courts have to control for the circumstances that are actually in place |
| Sent back to the TC to consider the license agreement |

|  |
| --- |
| General Electric Capital Canada v Queen 2010 DTC 7053 FCA |
| GECC a sub of GECUS, which provided financial services, and was financed by debt. 1988-1995 GECUS explicitly guaranteed GECC’s debt for free. Starting 1996 it began charging GECC a 1% fee on the face value of loans it guaranteed, which GECC deducted from its income. CRA reassessed under s69(2) (now 247(2)), saying that these charges would not have been made if the parties were dealing at arms length. GECUS would have guaranteed debt anyways (implicit guarantee from being the parent company), so payments added no value.  Issue: was the payment of the fee reasonable for a NALP? |
| TC: held for TP |
| Without guarantee, GECC’s credit rating would have been much lower. Guarantee had economic benefit, therefore value that GECUS could charge for. <wrongly focused on effect of removing the guarantee> |
| FCA: held for TP |
| TJ in error to consider effect of removing guarantee.   * + Can’t analyze from the basis of a hypothetical. Have to consider the REAL transaction, but abstract away from it the distortions caused by the parties being NAL.   MNR argues that this was a dividend, not a payment because there was an implicit guarantee that the parent company was going to back the sub up anyway |
| TP argues that you have to abstract completely from NAL and treat GEC as if there was no connection. |
| * + Consistent with Glaxosmithkline- look at the business circumstances of this TP |
| An explicit guarantee would boost their credit rating , and there is no evidence that an implicit one would have the same effect   * + Guarantee obviously has some value, and if ALP GEC Ca would have had to pay for it |

## Thin Capitalization

#### ITA 18(4)

Prevents a resident corporation from deducting interest on a portion of its loans from specified non-resident that have a significant ownership interest in the resident corporation *<operation shown below>*

* + Interest deduction will be denied where
    - Outstanding debts of the specified non resident shareholder exceed two times the permitted equity
      * If debt: equity ratio exceeds 2:1 (was 3:1 before 2000)then interest relating to excess debt will be disallowed

#### ITA 18(5)

Defines “specified non resident shareholders”

* + Person who alone, or together with NALP, owns shares giving them:
    - 25% of the voting stock OR
    - shares equaling 25% or more of the FMV of the all the issued and outstanding shares of the corp

Defines “outstanding debts to specified non-residents ”

* + Broad definition- payable by the corporation to a person who was, at any time in the year a specified non resident, or NAL to a specified non resident

##### Operation of the Thin Capitalization Rules

No amount is deductible that is greater than the proportion of

a/b where

* + a= (i) – (ii)
    - (i) = avg. of highest monthly debt owing to the SNR
    - (ii) = 2x the capital of the company or 2x the equity of the SNR
  + b= average monthly debt owing to a SNR

thus: disallowed portion of interest = (i) – (ii)

(i)

ex 750 -2(250)/ 750 = 1/3 -> gives the proportion of the debt that is disallowed

#### ITA 18(6)

ANTI AVOIDANCE

If a loan is made by a SNR s/h or a NAL to a SNR s/h on the condition that a subsequent loan will be made to particular corporation resident in Canada, then for the purposes of 18(4) and (5) the lesser amount of the first loan and the amount of the second loan shall be deemed to be debt incurred by the particular corp to the person who made the first loan..

* + “Look-through” rule: Can’t get around rule by interposing an intermediary

#### CAN-US XXV (7), (8)

7. Except where the provisions of paragraph 1 of Article IX (Related Persons), paragraph 7 of Article XI (Interest) or paragraph 7 of Article XII (Royalties) apply, interest, royalties and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purposes of determining the taxable profits of the first-mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of a resident of a Contracting State to a resident of the other Contracting State shall, for the purposes of determining the taxable capital of the first-mentioned resident, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

8. The provisions of paragraph 7 shall not affect the operation of any provision of the taxation laws of a Contracting State:

* + (a) Relating to the deductibility of interest and which is in force on the date of signature of this Convention (including any subsequent modification of such provisions that does not change the general nature thereof); or
  + (b) Adopted after such date by a Contracting State and which is designed to ensure that a person who is not a resident of that State does not enjoy, under the laws of that State, a tax treatment that is more favorable than that enjoyed by residents of that State.

|  |
| --- |
| Wildenburg Holdings Ltd |
| Case that suggests that these provisions only apply to corporations |
| Hypothetically, if you got the SNR to loan to a partnership to make a back to back loan through an unrelated corp you would be out, except for the GAAR |

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| --- |
| Canada Trustco |
| GAAR case |
| If you circumvent a provision then that can be deemed misuse |

|  |
| --- |
| Specialty Manufacturing Limited v The Queen 99 DTC 5222 FCA |
|  |
| Bank(US) Mayers (US) Bank (US) |
| \ / \ / |
| WF(US) ACE (US) |
| / |
| SM (CAN) |
|  |
| SM got contract for expo 86, and borrows money from WF and ACE, goes 10 million into debt and only has 100$ equity. SM is borrowing at same interest rates as from the bank, probably couldn’t borrow the money themselves. Tries to deduct their interest costs and is reassessed on the basis that their interest costs exceed the 3:1 ratio, so MNR wants to readjust according to 18(4). |
| CAN-US IX |
| 1. Where a person in a Contracting State and a person in the other Contracting State are related and where the arrangements between them differ from those which would be made between unrelated persons, each State may adjust the amount of the income, loss or tax payable to reflect the income, deductions, credits or allowances which would, but for those arrangements, have been taken into account in computing such income, loss or tax. |
| Issue: are ACE and SM specified non residents? |
| Held: for MNR |
| TP argues since they are paying the same interest rate as from the bank, they are paying NAL interest |
| * + NAL adjustment shouldn’t occur when things are AL |
| CRA concedes that this is an AL capital structure and interest rate (Can’t be right) |
| Conclusion |
| * + This is not an AL capital structure ($10m debt to $100 equity in 1986, totally ridiculous). AL parties would never lend like this. |
| * + The TP was trying to flip the treaty, which |
| * + - You can’t do |
| * + - And an AL interest rate cannot create an AL capital structure |



###### PART II: TAXATION OF NON –RESIDENTS ON CANDIAN SOURCE INCOME

# CHAPTER 4: Employment Income

## Income from Office or Employment in Canada

Non residents of Canada are subject to tax under ITA s 2(3) and 115 (1)(a) on:

* + Income from O/E in Canada
  + Income from B/P in Canada
  + Taxable capital gains from the disposition of taxable Canadian property
  + Certain other Canadian source income

3 kinds of issues come up

1. Characterization of Source by Income type (O/E, B/P, Dividends)
   * Different treaty provisions appley
2. Determination of Source Jurisdictionally
3. What income is attributable to the Canadian activity
   * Active income- taxed where the activity takes place
   * Passive income- taxed where the payer is resident
   * CG is sourced where the property is situated

##### Domestic Provisions

#### ITA 2(3)

Non residents are taxable on income earned in Canada if at any time in that year or the previous year the TP was

* + (a) employed in Canada
  + (b) carried on business in Canada
  + (c ) disposed of taxable Canadian property

#### ITA 115 (1)(a)(i)

requires income from an office or employment in Canada to be included in a non-residents calculation of income earned in Canada

(a) no income other than

* + (i) the income from O/E performed in Canada
  + (ii) the business income carried on in Canada
  + (iii) taxable CG from dispositions described in 115(1)(b)

(c ) taxable Canadian property other than treaty protected property

#### ITA 115 (1)(a)(v)

non resident subject to tax if under 115(2)

non resident is required by paragraph 115(2) (e) to include

Must include

* + Indirect or direct remuneration
  + Canadian sourced scholarships, fellowships, bursaries and prizes over 500 that aren’t prescribed
  + Taxable person of Canadian sourced resource grants

#### ITA 115(2)

deemed employment in Canada if the non resident was:

(a) a full time student at post secondary institution

* + includes scholarships

(b) if you are a student or teacher was a resident in Canada but moved to take classes or teach at a post secondary level

(c ) if you moved to do research on a grant

(d) if moved and now gets paid for office or employment

(e) if could reasonably be regarded as an inducement or partial remuneration for services performed in Canada

if a person performs services partly in Canada and partly in another state, the income is allocated to both jurisdictions on a reasonable basis and only the Canadian portion is taxable in Canada (ITA s 115(1)(a), 4(1)(b)

##### Treaty Provisions

for tax treaty purposes, the distinction between employee and independent contractor is also important

* + for “independent service providers” the threshold for source taxation is much higher, you need to have a FIXED BASE
  + for “dependent service providers” (employees) the threshold is based on 183 day test, or the residence of the employer
  + this determination is based on domestic law,

Canadian tax treaties limit source country jurisdiction by imposing 183 day threshold

* + If employer is resident in Can (can deduct wage)
  + And the employer has a fixed base

Some treaties (ie CAN-US) also have a de minumus exception

* + Ie if you make under 10,000 from an employment it is not taxable.

|  |
| --- |
| 671122 Ontario Ltd v Sagaz Industries [2001] SCJ |
| SCC said that the central question is whether has been engaged to perform services is performing them as a person in business on his own account |
| * + Look to Wiebe Door Criteria: is integration, risks, ownership of tools, opportunity for profit, control |

#### OECD Art 15, 16,18,19

ARTICLE 15 EMPLOYMENT INCOME

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

* + the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
  + the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
  + the remuneration is not borne by a permanent establishment which the employer has in the other State.

3. in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

Notwithstanding the preceding provisions of this Article, remuneration derived

ARTICLE 16 DIRECTORS’ FEES

Directors’ fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

ARTICLE 18 PENSIONS

Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

ARTICLE 19 GOVERNMENT SERVICE

1. a) Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

* + b) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:
    - is a national of that State; or
    - did not become a resident of that State solely for the purpose of rendering the services.

2. a) Notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

* + b) However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.

3. pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

ARTICLE 20 STUDENTS

Payments which a student or business apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.

#### CAN-US XV, XVII, XVIII, XIX

#### CAN-UK Art 15,17,18

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| Wolf 2002 FCA |
| TP worked at bombardier for 5 years. Not integrated, no job security, no intention to be employee. Court held he had no fixed base and was thus an independent contractor and not an employee. |

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| --- |
| Gu v MNR [1991] 2 CTC 2093, 91 DTC 821 (TCC) |
| TP had an LLB from China, came to Dal to do his masters, was always a resident in China. Had a job at a firm as a “business trainee”. Used money to support family while completing studies. TP said pay was exempt as it was for the purpose of his education, reassessed on it being from O/E |
| CAN-CHINA Art 19 |
| Payments that student gets solely for the purpose of his education or training shall not be taxed in that contracting state |
| Issue: is this income from employment or exempt? |
| Held: for MNR |
| TP said that taxing would violate the object and spirit of the treaty as only needed job to get degree |
| Court said that while art 19 should be given liberal interpretation, but no so broad as to include payments of salaries or wages   * + Treaty said payments exempt if “received…for the purpose of” education. Therefore doesn’t include amounts received by people who just happen to be students. |
| Duff- maybe if they had paid tuition directly, or if amounts had been tied to financial need as a student. |

|  |
| --- |
| Khabibulin v The Queen 100 DTC 1426 TCC |
| TP drafted by Win. Jets. Got signing bonus of $104k (plus some other shit). Reports income on the basis that signing bonus was exempt. MNR assessed on the basis that the signing bonus was not covered by the treaty and therefore forms part of his income taxable in Canada. |
| CAN- USSR Art 12(4) |
| Income from athlete from activities in other state taxable only in resident state if income is: |
| * + (a) **derived from public performaces** |
| * + (b) represents prizes, premiums, remuneration paid to participants and winners of sportive and other performances and competitions |
| Issue: was signing bonus for playing hockey, or just for signing the K? (ie. was it derived from playing hockey?) |
| Held: for TP |
| TP said was part of total consideration for playing |
| MNR said words of “singing bonus” are clear and thus must be taxed under 115(2)(c..1)(i) which specifically brings such a bonus into income |
| * + This provision says if you get a signing bonus in respect to activities performed in Canada you are deemed to have performed them in Canada |
| Court says was for playing hockey |
| * + Paid in 2 installments, wouldn’t get the second if he didn’t play |
| * + It was clear the TP considered the entire amount to be for playing hockey (as did his agent, when he got it) |

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| Prescott v Canada 1995 2 CTC 2068, 96 DTC 1372 TCC |
| TP US resident with two jobs in Can, one paying 56K other paying 2.5K. Can-US treaty exempts income <10k. MNR argues that applies to aggregate income, TP argued it applies to each income. |
| CAN-US XV |
| 1. Subject to the provisions of Articles XVIII (Pensions and Annuities) and XIX (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State. |
| 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of **an employmen**t exercised in a calendar year in the other Contracting State shall be taxable only in the first-mentioned State if: |
| * + (a) Such remuneration does not exceed ten thousand dollars ($10,000) in the currency of that other State; or |
| (b) The recipient is present in the other Contracting State for a period or periods not exceeding in the aggregate 183 days in that year and the remuneration is not borne by an employer who is a resident of that other State or by a permanent establishment or a fixed base which the employer has in that other State. |
| 3. Notwithstanding the provisions of paragraphs 1 and 2, remuneration derived by a resident of a Contracting State in respect of an employment regularly exercised in more than one State on a ship, aircraft, motor vehicle or train operated by a resident of that Contracting State shall be taxable only in that State. |
| Issue: does 10k expemption apply to aggregate income, or to each individual employment. |
| Held: for TP |
| TP says treaty says AN employment not ALL employment, so the SFU thing should be separate |
| MNR uses |
| Interpretation Act s 33 |
| * + Words in the singular include the plural, and words in the plural include the singular |
| Court sees not reason not to use the plain an ordinary meaning of the word “an” |
| * + Would have been simple for treaty to say all employment and it doesn’t 🡪 therefore exempt |

|  |
| --- |
| Hale v Canada 1992 962 TC 6370 FCA |
| TP was Canadian resident employed by Alcan, a Canadian co, he was CFO. He was granted share purchase options. Then quit 2 years later and moved to England, but was still allowed to exercise options. Exercised options and got $125, 000, less a tax deduction of 30,000. MNR said this deduction was the amount owed in tax to a benefit conferred on the TP in respect to Canadian income .TP argued that since he did not “exercise” any “employment” in Canada in the year he used the options, therefore they should be exempt under the CAN-UK treaty art 15 |
| CAN-UK Art 15 |
| Says that employment income is taxable only in the resident state unless the employment is exercised in the other state |
| Issue: was employment exercised at the time the option was taken? |
| Held: for MNR |
| * TP Argues the legislature intended to exclude the case of someone who had previously exercised employment in Canada and that |
| * Says 7(4) of the ITA is inconsistent with the Treaty and cannot apply |
| * + States that when a person to whom any provisions in subsection (1) would apply has ceased to be an employee before all things have happened that would make the provisions applicable, then (1) will continue to apply as though the person were still an employee |
| * + - TP fails to make the argument as to why using a past verb here makes it inconsistent , rather the 2 provisions are complimentary |
| * TP is deemed to have exercised employment in Canada |

##### Cases on Attribution of Income

|  |
| --- |
| Austin v The Queen 2006 3 CTC 2422, DTC 2181 TCC |
| TP was quarterback in the CFL from 1987 to 1996. Got paid by the BC Lions and the TO Argonauts. Played a few games each year in the US. MNR wants to allocate income for tax purposes based on the number of days/season in the US (most income in Can) while the TP wants to allocate based on US Games/Can Games a season. |
| Issue: how do you allocate? |
| Held: for TP |
| Court says allocation per game is more reasonable |
| * + His contract stipulated that he was paid ONLY for games he played unless injured |
| * + - Note how this is different from hockey contracts |
| * + His pay was divided by games |

|  |
| --- |
| Sutcliffe v The Queen 2005 TCC812 TCC Former Air Canada Pilot , non resident of Canada during the 1996, 1997 , and 1998 taxation years. Lived in NY but commuted to the TO airport. TP excluded income earned from international flights and renumeration in “other pay” category. Only wanted to be taxed in Canada on domestic Canadian flights. Said taxing only on domestic flights is the “ traditional method” MNR wants to tax it all on the basis that if you are being paid by a Canadian airline you are performing your duties, unless those duties actually took place not in Canada. MNR allocated a very small part of pay to international flights as not taxable. |
| Issue: Allocation of Remuneration |
| Held: for TP (partially) |
| * Sent back to reassess the remuneration related to duties reasonably attributable to duties performed outside Canada in regards to domestic flight |
| * However, this is generally salary and the court generally rejects the proposition that some portion of the general remuneration has no income –earning nexus in Canada. |
| * International and domestic flight income should not be taxed to the extent that the aircraft passes through the United States |
| * + The only relevant factor to be considered is whether the remuneration is attributable to duties performed in Canada. If it is not attributable to services performed in Canada, it is not taxable in Canada |
| * General rule of the court seems to be that if you actually performed outside Canada it is not taxable, but if its general pay from a Canadian company its taxable * **RESULT: airline employees are taxable in US/CAN for the portion of their flight that is over that airspace** |



# CHAPTER 5: Business Income

## Carrying on Business in Canada through a Permanent Establishment

Marks the line between active and passive income

Technically, s 2(3) (b) of the ITA is applicable where

* + The activity of the non resident constitutes a business
  + The activity is carried on in Canada
  + The taxable income is derived from such activity

But, tax treaties limit Canadian tax jurisdiction by requiring the existence of a permanent establishment in Canada

#### ITA 2(3)(b) and 115(1)(a)(ii)

Require a business to be carried on in Canada

* + Business
    - Organized activity with a profit purpose
  + Carried on
    - Where the profits are made
    - This is not a single AINT

Note that the ITA 248(1) definition of business includes AINTS, but you cannot use this extended definition (see *Tara Explorations* )

##### Common Law Tests for Where a business is carried on

Place where the sales contracts are made

* + Can be easily manipulated

Place of operations

* + Purchases of materials
  + Manufacture or production of goods
  + Location of inventory
  + The solicitation of orders , delivery and payment
    - Come from *Gurds Products*

#### ITA s 253

Enacted to overrule *Tara Exploration*

DEEMS a non –resident to be carrying on a business in Canada if

(a) produces , mines , creates, grows, 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

* + includes bot h tangible and intangible property, services

(b) solicits orders or offers anything for sale in Canada through and agent or servant, whether the contract or transaction is to be completed inside or outside of Canada….

* + “in Canada” means the action of soliciting, not that the subject matter must be in Canada
    - *Maya Forestales*

(c) disposes of Canadian resource property, timber property , real property, inventory- no matter where the sale takes place

#### OECD Art 7

1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State 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 paragraph 2 may be taxed in that other State.

2. For the purposes of this Article and Article [23 A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the 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 permanent establishment and through the other parts of the enterprise.

* + Attribution according to
    - Functions peformed
    - Assets used
    - Risks assumed

3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.

* + Requires resident state to adjust the profits if the source state is taxing under paragraph 2

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.

* + Means that this can be trumped by other articles (ie article 8)

#### OECD Article 5

Defines permanent establishment

1. For the purposes of this Convention, the term “permanent establishment” means a **fixed place of business through which the business of an enterprise is wholly or partly carried on.**

* + commentary
    - place of business
      * low threshold
    - fixed
      * permanence, but looks at the link between the business and the point of the business
    - carried on through locations
      * wide meaning, need not be productive or permanent, just rehgular

2. The term “permanent establishment” includes especially: a **place of management; a branch; anoffice;**

**a factory; a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources**.

* + DEEMING rule

3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:

* + the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
  + the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise; the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
    - NOT a permanent establishment

5. than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment 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 in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

* + DEEMING rule if you have an agent habitually exercising authority on behalf of the enterprise, unless the agents behavior is covered by para 4

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

* + Means you can have an INDEPENDENT agent you are not necessarily deemed to be a permanent establishment

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

* + Sub NOT DEEMED to be a PE, it depends on what kind of activities it carries on

#### CAN-US VII

1. The business profits of a resident of a Contracting State shall be taxable only in that State unless the resident carries on business in the other Contracting State through a permanent establishment situated therein. If the resident carries on, or has carried on, business as aforesaid, the business profits of the resident may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where a resident of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident and with any other person related to the resident (within the meaning of paragraph 2 of Article IX (Related Persons)).

3. In determining the business profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. **Nothing in this paragraph shall require a Contracting State to allow the deduction of any expenditure which, by reason of its nature, is not generally allowed as a deduction under the taxation laws of that State.**

* + nothing in the treaty shall allow a deduction that would be disallowed domestically

4. No business profits shall be attributed to a permanent establishment of a resident of a Contracting State by reason of the use thereof for either the mere purchase of goods or merchandise or the mere provision of executive, managerial or administrative facilities or services for such resident.

5. For the purposes of the preceding paragraphs, the business profits to be attributed to a permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.6. Where business 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.

7. For the purposes of the Convention the business profits attributable to a permanent establishment shall include only those profits derived from the assets or activities of the permanent establishment

#### CAN-US XIV

Independent Personal Services

Income derived by an individual who is a resident of a Contracting State in respect of independent personal services may be taxed in that State. Such income may also be taxed in the other Contracting State if the individual has or had a **fixed base regularly available to him** in that other State but only to the extent that the income is attributable to the **fixed base.**

#### CAN-US V

Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on.

2. The term "permanent establishment" shall include especially: (a) A place of management;

(b) A branch; (c) An office; (d) A factory; (e) A workshop; and (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 permanent establishment if, but only if, it lasts more than 12 months.4. The use of a drilling rig or ship in a Contracting State to explore for or exploit natural resources constitutes a permanent establishment if, but only if, such use is for more than 3 months in any twelve- month period.

5. A person acting in a Contracting State on behalf of a resident of the other Contracting State- other than an agent of an independent status to whom paragraph 7 applies-shall be deemed to be a permanent establishment in the first-mentioned State if such person has, and habitually exercises in that State, an authority to conclude contracts in the name of the resident.

6. Not withstanding the provisions of paragraphs 1, 2, and 5, the term "permanent establishment" shall be deemed not to include a fixed place of business used solely for, or a person referred to in paragraph 5 engaged solely in, one or more of the following activities:

* + (a) The use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the resident;
  + (b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display or delivery;
  + (c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;
  + (d) The purchase of goods or merchandise, or the collection of information, for the resident; and
  + (e) Advertising, the supply of information, scientific research or similar activities which have a preparatory or auxiliary character, for the resident.

7. A resident of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

8. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not constitute either company a permanent establishment of the other.

9. Subject to the rule on construction, an enterprise is deemed to have provided its services through a permanent establishment if

* + the services are provided for 183 days in a 12 month period and make up 50% of the gross active business revenues AND
  + the services are provided to the same or connected residents of that state who maintain a permanent establishment and the services are provided through that permanent establishment

10. For the purposes of the Convention, the provisions of this Article shall be applied in determining whether any person has a permanent establishment in any State.

#### CAN-UK Article 14

Professional Services

Income derived by an individual who is a resident of a Contracting State in respect of professional services or orther independent activities of a similar character shall be taxable only in that state unless he has a fixed base regularly available to him in the other contracting state for the purpose of performing his activities,. If he has such a fixed base, the income may be taxed in the other contracting state but only so much of it as is attributable to that fixed base

#### CAN-UK Article 7

Business Profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment situated in a Contracting State, there shall be allowed as deductions expenses of the enterprise (other than expenses which would not be deductible under the law of that State if the permanent establishment were a separate enterprise) which are incurred for the purposes of the permanent establishment including executive and general administrative expenses, whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles embodied in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Convention, the provisions of this Article shall not prevent the application of the provisions of those other Articles with respect to the taxation of such items of income.

#### CAN-UK Article 5

Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

* + (a) a place of management;
  + (b) a branch;
  + (c) an office;
  + (d) a factory;
  + (e) a workshop;
  + (f) a mine, quarry or other place of extraction of natural resources;
  + (g) a building site or construction or assembly project which exists for more than 12 months.

3. The term "permanent establishment" shall not be deemed to include:

* + (a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
  + (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
  + (c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
  + (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
  + (e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

4. A person-other than an agent of an independent status to whom paragraph 5 applies-acting in a Contracting State on behalf of an enterprise of the other Contracting State shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that first-mentioned State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

#### ITCIA s 4

For the purposes of the allocating profits to a permanent establishment in Canada

* + (a) include anything that would be taxable under domestic law
  + (b) not allow anything that would not be deductible by a Canadian resident

this is an anti-discrimination provision

##### Cases: Carrying on a Business

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| Gurds Products |
| carrying on business in Canada is relevant for deemed residence |
| taxable in the source jurisdiction if there is no treaty |
| Court held business being carried on in Canada because |
| * + Intended to carry on business in Canada |
| * + Established bank account in Canada |
| * + Purchased product in Canada and earned profit from it |
| * + Had official agent in Canada |
| * + Its associates involved were not dealing at arms length |
| * + - Note: had no office, employees, and all decisions and negotiations in the US |

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| --- |
| GLS Leasco Inc and McKinlay Transport Ltd v MNR |
| GLS leasco is wholly owned American sub of Centra Inc(US Corp). McKinley is Ontario corp, and a wholly owned sub of Central Cartage (US), which is a wholly owned sub of Centra (US). McKInley leased rental equipment owned by GLS and used in its Candian business. McK made rental payments to GLS. MNR reassess McK on the basis that they failed to withhold tax on the rental payments. TP argues that if GLS was carrying on business in Canada then they didn’t need to withhold, but would just be taxed as rental income on GLS. |
| Issue: was GLS carrying on business in Canada? |
| Held: for TP ( taxed under pat I not part XIII) |
| MNR said no permanent establishment |
| * + Control/management in the us |
| * + No soliciting/offering for sale in Canada |
| * + Had no office/agent |
| TP argued that because of their modus operandi they didn’t need outward commercial trappings of being in business in Canada. |
| * + Could use McK office for signing docs and as a mailing office |
| * + All purchase orders made in Canadian dollars |
| * + Had Canadian bank account |
| * + GLS intended to do business in Canada |
| * + McK employees were always available to help |
| Court says that while perhaps not all the form was present, the substance of doing business in Canada was evident in this case |

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| Sudden Valley Inc v The Queen 1976 76 DTC 6448 FCA |
| TP was US company engaged in business of selling land in Sudden Valley. Originally sold to people in Washington, but then wanted to turn to Vancouver market. Leased a place in Van, had phone office and employees, but not a single sale was made in Van. There was a large advertising campaign but it only encouraged people to “visit” Sudden Valley, didn’t even say there was land for sale there. No agent or authority in Canada could accept an offer. All payments in US funds and no one in Can could take money other then to forward it on to the US company. MNR argues carrying on business and that interest paid on sales should be subject to withholding tax in Can under ITA 253(b). |
| Issue: was the TP carrying on business in Canada? |
| Held: for TP |
| MNR |
| * + Said TP was carrying on business because leased premise, advertised and had employees |
| In absence of any other evidence, the place where contracts are concluded is decisive |
| They were not soliciting orders, was a mere invitation to treat |
| * + Nothing offered for sale in Canada through and agent or otherwise |
| Only activity in Canada was inducing Canadians to visit Sudden Valley and any interest payments resulting fro mthe real estate business in the US is too remote from Canadian activities |

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| Tara Exploration and Development Co v MNR 1970 Exct Ct |
| Court held that an isolated business transaction lacked continuity implied in the concept of carrying on a business. |
| 253(b) was added to overrule this |

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| Maya Forestales SA v The Queen |
| TP is a company in Costa Rica, offered Canadians the chance to invest in teak tree planation. Canadians signed contracts with TP to develop the lot by planting and growing trees with a view to cutting them and marketing the timber. Separate K’s for developing, all were signed in Canada and forwarded to CR. NO treaty with CR, so TP didn’t want to file CAN tax return. Reassessed by MNR on the basis that they carried on business and are liable to tax on income in Canada under 2(3), 115(1)(a)(ii) and 253(b). |
| Issue: was TP carrying on business in Canada? |
| Held: for MNR |
| TP argued that 253(b) doesn’t apply because of the words “in Canada” |
| * + The timber lot wasn’t in Canada |
| * + Court says no, the key words are “solicit in” 🡪 caught by the deeming provision |
| TP argued all profit making activity was in CR |
| * + Court says no, in Canada means the action of offering, soliciting or selling |
| * + Here, contracts were signed in Canada with a representative |
| * + The intent of all the contacts signed was to sell timber harvesting business to investors |

##### Cases: Permanent Establishment/Fixed Base

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| --- |
| Fowler v MNR [1990] 2 CTC 2351 |
| TP resident of California in business of selling knives, carwashing mitts and other things at fairs via his portable trailer. He came to the PNE for 2-3 weeks over 15 years. Had non exclusive (revocable) license to sell at the PNE but this had never been revoked. Equipment (trailer and booth) were movable, he normally took back to Cali but left them in Vancouver one year for the purpose of having them repaired. Made about 10% of his income at the PNE |
| Issue: is he carrying on business in Canada through a permanent establishment? |
| Held: for MNR |
| Carried on a business by offering goods for sale and concluding contracts |
| TP argues entry to Can temp and conditional, he was only there a short period, and cannot be reached by his customers. His is equipment collapsible and mobile |
| * + Relies on OECD commentary definition of what a permanent establishment is |
| * + - Place |
| * + - Fixed |
| * + - Business must be carried on through |
| * + He says none of these things |
| RA argues there is permanency in the operation |
| * + Never revoked license, and he’s been doing it for 15 years, |
| * + The nature of business doesn’t need anything more permanent |
| * + Canadian operation was not sideline or incidental |
| Can-US Article VII Business profits |
| * + Need permanent establishment |
| * + The profits attributable to the PE are the ones derives from its assets or activites |
| Can-US Article V |
| * + Fixed place of business though which the business of the resident is fully or partly carried out |
| * + Permanent establishment includes especially |
| * + - Place of management, branch office, factory, workshop, place of extraction of natural resources |
| Court decides that it is a PE, he’s been permanently recurring for 15 years |
| * + PNE amounted to a significant proportion of his business   + Permanent doesn’t have to be “permanent-all-the-time,” can be a “permanently coming back repeatedly” thing. (ie. doesn’t have to be continuous, can simply be recurring). |
| * + Nature of the business itself is important , for this TP his booth is the same as a place of management or office |

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| --- |
| Dudney v The Queen 2000 FCA ( appeal to SCC dismissed) |
| \*\*\* note, this was controversial and eventually reversed by treaty amendments\*\*\* |
| TP was a programmer, resident of the US and came to CAN for a contract, based in Calgary. K could be terminated on 30 days notice, but thought it would take a year to complete. All business took place in Calgary. TP took all equipment from Houston, gave no indication he worked for Pan Can, no Calgary business license, his cheques were sent to Houston. He spent 345 day in Can over 2 years and terminated the K himself. Reassessed on basis that he had fixed base according to: the former CAN-US Article 14 |
| “income derived from a resident in a Contracting state… taxable only in that state unless he has a fixed base regularly available to him in the other Contracting state for the purpose of performing his ativities” |
| Issue: is he carrying on his own business through a fixed base? |
| Held: for TP |
| TCC:   * + decided on the basis that the TP had no control over the premises in which he worked, so there is no fixed base |
| FCA: |
| RA argues that the nature of the TP’s business doesn’t require a base (similar to *Fowler*) |
| * + He couldn’t be denied access as long as he was performing his K , the fact that he didn’t have access at other times is irrelevant |
| Court uses lawyer analogy to conclude no fixed base |
| * + If one was flying to the US to meet a client would not be taxed (duff says it might be problem that he was there 345 days) |
| Dec 2008 CAN-US Art V, para 9 |
| * + If applied to this case, he would be likely be deemed to have a PE |

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| Knights of Columbus v The Queen [2009] 1 C.T.C. 2163, 2008 D.T.C. 3648 (T.C.C.). |
| Roman catholic fraternal organization morphed into insurance business. 25% of revenues come from insurance business, apparently not taxable in the US because of a charity like status. Based in Connecticut. 1 chief agent in Canada, and then military model down |
| Chief agent- paid an hourly fee and reimbursed for expenses( sounds like IC), |
| Field directors |
| General agents- more significant, supposed to recruit and train field agents , home offices, no signs advertising, income came from commission override by the field agents , benefits provided by KOC (sounds like employees) when recruited, |
| Contracts were between Head Office and the GA, and FA. Considered themselves in role of franchisee |
| Field Agents (220)- front line workers who solicit applications for KOC insurance products, could only solicit to members of KOC. Operate in K with KOC, GA. |
| * + Under this they are authorized to solicit and purport applications for insurance and to collect the initial premium. |
| * + Not authorized to bind, of modify the insurance policy etc etc etc. |
| No employee relationship between KOC, GA, FA.. GA could impose requirements on FA, but no requirements from KOC. Paid on commission but also got benefits. Deals took place in homes of the customers When application were solicited they issued a receipt and a temporary insurance certificate that would insure the customer in the case something happened before their application for the real insurance was processed |
| Issue: do Knights of Columbus CoB through a PE? |
| Held: for TP |
| Carrying on business for domestic law? |
| * + 253(b) soliciting business through and agent or servant 🡪 YES |
| Dependent agent PE? |
| * + Para 5, Article V |
| * + “Dependent Agency” PE: |
| * + - To be this, agent must be: |
| * + - * Be DEPENDENT |
| * + - * HABITUALLY CONCLUDE K’s |
| Dependent/independent agent PE, who is this? |
| * + The CA- independent (para 50) |
| * + The GA- independent , |
| * + - court says this is separate business not legally or economically dependent on KOC (Duff says this economically independent is troubling because they make their money by soliciting ppl to sell KOC insurance) |
| * + The FA- dependent- but the court says its immaterial b/c they don’t have the HABITUAL AUTHORITY TO CONCLUDE K’s . Why? |
| * + - its not concluded until the Connecticut people approve the permanent insurance |
| * + - Temp insurance is basically a promotional gift (could have given free cruise?) they arnt in the business of temp insurance. ONLY BUSINESS IS PERM INSURANCE (duff seems to be skeptical) |
| Is there a KOC Fixed base PE? |
| * + Court says the FA have place of business, but its not the KNOC place of business |
| * + - The home offices is admin, |
| * + (But the KOC business is taking place in the members homes?) |
| Article in UN model about insurance |
| * + Art V(VI) |
| * + Deemed PE if it collects premiums and insuring risks in the other state through agents of dependent status |
| * + so CAN-US didn’t include this- they opted out |
| * + is this persuasive? |
| * + Brian Arnold- argues there is reciprocity, its probably happening on both sides, which is fine as long as tis fairly equal |
| So KOC escapes from all taxation |
| * + The problem in this case is KOC is somehow charitable in the US and not taxable |

##### Cases: Attribution of Income

|  |
| --- |
| Cudd Pressure Control Inc v The Queen 1999 FCA |
| CP is incorporated and a resident in the US, provided oil well services. In September there was a blowout with a company named Mobil in NS. M contacts CP in order to remedy. CP sent snubbing units, very expensive, custom built. CP owned only the 600 unit in the world. Work was carried out in 84/85, units were sent up to CAN and used offshore. TP reported income as through a PE, and deducted labour costs, overhead expenses, insurance and a proportion of notional rent (2.5 million dollars). MNR disallows notional rent on 18(1)(a).an expense incurred IPP test and Section 4(b) ITCIA- domestic resident cant deduct notional rent |
| Tax court says if this were independent this K wouldn’t have happened. |
| Issue: Can corporation doing business in CAN but incorporated in the US deduct notional rent under the treaty, when a corresponding deduction is disallowed for a CAN corporation under the ITA? |
| Held: for MNR |
| * TP argues that express provisions in the treaty allow, and to treat as if they were distinct, separate and dealing wholly independently |
| * + Could argue that 18(1)(a) because not actually deducting the rent, just computing the profits |
| * + Indicating an amount that they would deduct if they were independent |
| * What to take from this: if the deduction isn’t available to a CAN corporation, then an international can’t do it under the treaty |
| * Note: if the CAN branch had been a separate AL corporation instead then this would have been ok |
| * + BUT if they were unrelated this probably wouldn’t have happened, only one of these things in the world. |

## Artistes and Sportsmen

* Different rules in attempt to tax on a source basis the large amounts of business income these people can make in a very short period of time in many different countries

#### OECD Art 17

1. Notwithstanding the provisions of Articles 7 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, **may be taxed in that other State [source state]**

* + Means that if you’re in this category you don’t need a PE, taxed in source state

2. Where income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may, notwithstanding the provisions of Articles 7 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised.

* + Anti-avoidance rule
    - **If the money accrues to another person (not the entertainer themselves, ie a corp.) that income may be taxed in the contracting state** 
      * Means you can’t set up a corporation in between
      * Intent is to catch the diversion

#### CAN-US XVI **(same as OECD, but with exception for sports teams)**

1.  Notwithstanding the provisions of Articles XIV (Independent Personal Services) and XV (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities do not exceed fifteen thousand dollars ($15,000) in the currency of that other State for the calendar year concerned.

* + Unless its under 15,000

2.  Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete but to another person, that income may, notwithstanding the provisions of Articles VII (Business Profits), XIV (Independent Personal Services) and XV (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised. For the purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

3.  The provisions of paragraphs 1 and 2 shall not apply to the income of:

* + (a) an athlete in respect of his activities as an employee of a team which participates in a league with regularly scheduled games in both Contracting States; or
  + (b) a team described in subparagraph (a).

4.  Notwithstanding the provisions of Articles XIV (Independent Personal Services) and XV (Dependent Personal Services) an amount paid by a resident of a Contracting State to a resident of the other Contracting State as an inducement to sign an agreement relating to the performance of the services of an athlete (other than an amount referred to in paragraph 1 of Article XV (Dependent Personal Services) may be taxed in the first-mentioned State, but the tax so charged shall not exceed 15 per cent of the gross amount of such payment.

* + So if you get a signing bonus, its taxable up to 15% of the gross amount

#### CAN-UK Art 16

1. Notwithstanding the provisions of Articles 7, 14 and 15, income derived by entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised.

2. Where income in respect of personal activities as such of an entertainer or athlete accrues not to that entertainer or athlete himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised.

3. The provisions of paragraphs 1 and 2 shall not apply:

* + (a) to income derived from activities performed in a Contracting State by entertainers or athletes if the visit to that Contracting State is wholly or substantially supported by public funds;
  + (b) to a non-profit making organization no part of the income of which is payable, or is otherwise available for the personal benefit of, any proprietor, member or shareholder thereof; or
  + (c) to an entertainer or athlete in respect of services provided to an organization referred to in sub-paragraph (b).

|  |
| --- |
| Cheek v The Queen 2002 2 CTC 2115 TCC |
| TP does play-by-play commentary on every single blue jays game since 1977 (at time of the case). He deducted income from Canada under the treaty (ITA 113) on the basis that he had no fixed base in CAN (skydome doesn’t count), gets reassessed on the basis that he has a fixed base (not discussed) or under the equivalent of what is now XVI |
| Issue: is he an artiste? |
| Held: for TP |
| MNR argues that he is a radio artiste as there is downtime in which he has to fill the space |
| TP says he is a broadcast journalist |
| Court says artist is person who has some sort of skillful land creative performance. The RA’s argument would make any news reporter an artiste.   * + It was the players who were doing the “performing,” he was just commentating on them (doesn’t count). |
| * + **An artiste must have creative talent, be performing** |

|  |
| --- |
| Sumner and Roxanne Music Inc v The Queen [2002] 2 CTC 2115 DTC |
| Sting has set up Roxanne (US resident) shares wholly owned by Wyneco , a Netherlands corp (owned by Mr Dickoff ). Roxanne pays Sting 95% of the net profits of his NA tour. Roxanne reports that it lost money on the Can part of this tour. Stings salary for the tour is about 1.48 mill, based on 6 days out of 240 in North America. Minister wants to asses based on revenue from Can concert. |
| Issue: Is corp liable for tax in Canada? method of allocating income? |
| Held: for MNR |
| TP (corp) argues no PE in Canada 🡪 court doesn’t buy it |
| Court says liable for source taxation under Can- US XVI (AA provision, as a performer) |
| * + Under para 2 Sting clearly participates in the profits, and the interpretive bulletin supports that this provision was enacted to catch this type of situation |
| * + - Court says para 2 contemplates a situation where the performers income may be earned part by the performer personally and in part by the company and both may be taxed. |
| * + Allocation issue |
| * + - TP wants can income to be 6/240 days (length of North American tour) |
| * + - * But there were days that have nothing to do with the tour |
| * + - MNR wants gross Can income/ gross NA tour income |
| 🡺 Court says TP’s method isn’t any better, so sticks with CRA’s reassessment. |



# CHAPTER 6: Capital Gains and Losses

## Taxable Canadian Property - LOOK AT HANDOUT!!!

Included in a non residents income earned in Canada is any excess of taxable capital gains over allowable capital losses that result from the disposition of taxable Canadian property

#### ITA 2(3)(c)

TP is liable to Canadian Income tax if the taxpayer disposed of any taxable Canadian property

Canadian property is taxed on a net basis in accordance with s 115 of the ITA

#### ITA 115(1)(a)(iii) & (b)

(1) for the purposes of the act, the taxable income earned in a taxation year of a person who at no time in the year is resident in Canada is the amount, if any, by which the amount that would be the non-resident person’s income for the year under s3 if:

* + (a) the non resident had no income other than
    - (iii) taxable capital gains from dispositions described in paragraph (b)
  + (b)the only taxable CG and allowable capital losses referred to in paragraph 3(b) were taxable capital gains and allowable taxable losses from dispositions, other than dispositions deemed under subsection 218.3(2) or taxable Canadian properties (other than treaty protected properties)

#### ITA 116

* withholding system, where purchaser has to withhold part of purchase price for tax owing by vendor

Key is Taxable Canadian Property

#### ITA 248(1)

Taxable Canadian Propety

For our purposes, these are the relevant categories

1. Real property in Canada (a)
2. Business assets of a business carried on in Canada (b). Includes capital, eligible capital property and inventory
3. Share of the capital stock of the corporation (or trust/partnership)\* that is not listed on a designated stock exchange (d)
   * + Except stock in mutual fund corporation/trust, or an income interest trust res. in Canada.

* **IF** (for a 60 month period), >50% of FMV of share/interest derived directly/indirectly from:
  + Real or immovable property
  + Canadian resource properties
  + Timber resource properties
  + Options/interests/etc in any of those.

1. Share of the capital stock of a corporation (or mutual fund corp/trust) that IS listed on a designated stock exchange, if at any particular time in the 60 month period that ends at that time (e),
   1. >25% of shares of any class (or units of a trust) are owned by TP/NALP, AND
   2. > 50% of the FMV of shares/units derived directly/indirectly from one or any combination of the items listed in (d)(i) to (iv) (#3 above).
2. The same rules that are applies to shares apply to trusts
3. The same rules that apply to shares apply to options and interests

Treaty Protected Property

* + “ treaty protected property of a taxpayer at any time means property any income or gain from the disposition of which by the taxpayer at that time would, because of a tax treaty with another country, be exempt from tax under part I

#### OECD Art 6

Immovable Property

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term “immovable property” shall have the meaning that it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

* + Immovable Property=
    - Real property
    - Stuff that is fixed
    - Livestock and equipment used in agriculture
    - Forestry equipment

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

#### OECD Art 13

CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

* + Gains from the disposition of immovable property situated in source state taxable in source state
  + Includes stuff accessory to immovable property

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

* + Gains from alienation of movable property that is part of/connected to a PE, or if you dispose of PE, it is taxable in the source state

3. Gains from the 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, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

* + Gains from the alienation of ships or aircrafts , boats or movable property if the alienation are taxable ONLY in the place where the place of management is located
  + International traffic principle

4. Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

* + Gains on shares with principle value in other state taxable on source

5. Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.

* + GENERAL RULE: based on residence.

#### CAN-US XVIII

1.  Gains derived by a resident of a Contracting State from the alienation of real property situated in the other Contracting State may be taxed in that other State.

2.  Gains from the alienation of personal property forming part of the business property of a permanent establishment which a resident of a Contracting State has or had (within the twelve-month period preceding the date of alienation) in the other Contracting State or of personal property pertaining to a fixed base which is or was available (within the twelve-month period preceding the date of alienation) to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment or of such a fixed base, may be taxed in that other State.

3.  For the purposes of this Article the term "real property situated in the other Contracting State"

* + (a) In the case of real property situated in the United States, means a United States real property interest and real property referred to in Article VI (Income from Real Property) situated in the United States, but does not include a share of the capital stock of a company that is not a resident of the United States; and
  + (b) in the case of real property situated in Canada means:
    - (i) real property referred to in Article VI (Income from Real Property) situated in Canada;
    - (ii) a share of the capital stock of a company that is a resident of Canada, the value of whose shares is derived principally from real property situated in Canada; and
    - (iii) an interest in a partnership, trust or estate, the value of which is derived principally from real property situated in Canada.
      * Extends to OECD model to include trusts and estates

4.  Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3 shall be taxable only in the Contracting State of which the alienator is a resident.

5.  The provisions of paragraph 4 shall not affect the right of a Contracting State to levy tax on gains from the alienation of property derived by an individual who is a resident of the other Contracting State if such individual:

* + (a) was a resident of the first-mentioned State for 120 months during any period of 20 consecutive years preceding the alienation of the property; and
  + (b) was a resident of the first-mentioned State at any time during the ten years immediately preceding the alienation of the property;

and if such property (or property for which such property was substituted in an alienation the gain on which was not recognized for the purposes of taxation in the first-mentioned State) was owned by the individual at the time he ceased to be a resident of the first-mentioned State.

6. Where an individual (other than a citizen of the United States) who was a resident of Canada became a resident of the United States, in determining his liability to United States taxation in respect of any gain from the alienation of a principal residence in Canada owned by him at the time he ceased to be a resident of Canada, the adjusted basis of such property shall be no less than its fair market value at that time.

* + Extends the capital gain exemption to principle residence

7.  Where at any time an individual is treated for the purposes of taxation by a Contracting State as having alienated a property and is taxed in that State by reason thereof and the domestic law of the other Contracting State at such time defers (but does not forgive) taxation, that individual may elect in his annual return of income for the year of such alienation to be liable to tax in the other Contracting State in that year as if he had, immediately before that time, sold and repurchased such property for an amount equal to its fair market value at that time.

* + Where an individual is treated as having alienated property in one state but not in the other, you can elect to have it taxed in both

8. Where a resident of a Contracting State alienates property in the course of a corporate or other organization, reorganization, amalgamation, division or similar transaction and profit, gain or income with respect to such alienation is not recognized for the purpose of taxation in that State, if requested to do so by the person who acquires the property, the competent authority of the other Contracting State may agree, in order to avoid double taxation and subject to terms and conditions satisfactory to such competent authority, to defer the recognition of the profit, gain or income with respect to such property for the purpose of taxation in that other State until such time and in such manner as may be stipulated in the agreement.

9.  Where a person who is a resident of a Contracting State alienates a capital asset which may in accordance with this Article be taxed in the other Contracting State and

* + (a) that person owned the asset on September 26, 1980 and was resident in the first-mentioned State on that date; or
  + (b) the asset was acquired by that person in an alienation of property which qualified as a non-recognition transaction for the purposes of taxation in that other State;

the amount of the gain which is liable to tax in that other State in accordance with this Article shall be reduced by the proportion of the gain attributable on a monthly basis to the period ending on December 31 of the year in which the Convention enters into force, or such greater portion of the gain as is shown to the satisfaction of the competent authority of the other State to be reasonably attributable to that period. For the purposes of this paragraph the term "non-recognition transaction" includes a transaction to which paragraph 8 applies and, in the case of taxation in the United States, a transaction that would have been a non-recognition transaction but for Sections 897(d) and 897(e) of the *Internal Revenue Code*. The provisions of this paragraph shall not apply to

* + (a) an asset that on September 26, 1980 formed part of the business property of a permanent establishment or pertained to a fixed base of a resident of a Contracting State situated in the other Contracting State;
  + (b) an alienation by a resident of a Contracting State of an asset that was owned at any time after September 26, 1980 and before such alienation by a person who was not at all times after that date while the asset was owned by such person a resident of that State; or
  + (c) an alienation of an asset that was acquired by a person at any time after September 26, 1980 and before such alienation in a transaction other than a non-recognition transaction.
    - Transitional rule
      * Exempts certain capital gains (K*ubicek* Case)
      * On CG on property after 1972 you would get a credit in the US
        + But you would be fully taxable in the US over that time

#### CAN-UK Art 13

**Capital Gains**

1. Gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing professional services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains derived by a resident of a Contracting State from the alienation of ships or aircraft operated in international traffic or movable property pertaining to operation of such ships or aircraft, shall be taxable only in that Contracting State.

4. Gains from the alienation of:

* + (a) any right, licence or privilege to explore for, drill for, or take petroleum, natural gas or other related hydrocarbons situated in a Contracting State, or
  + (b) any right to assets to be produced in a Contracting State by the activities referred to in sub-paragraph (a) above or to interest in or to the benefit of such assets situated in a Contracting State,

may be taxed in that State.

5. Gains from the alienation of:

* + (a) shares, other than shares quoted on an approved stock exchange, deriving their value or the greater part of their value directly or indirectly from immovable property situated in a Contracting State or from any right referred to in paragraph 4 of this Article, or
  + (b) an interest in a partnership or trust the assets of which consist principally of immovable property situated in a Contracting State, of rights referred to in paragraph 4 of this Article, or of shares referred to in sub-paragraph (a) above,

may be taxed in that State.

6. The provisions of paragraph 5 of this Article shall not apply:

* + (a) in the case of shares, where immediately before the alienation of the shares, the alienator owned, or the alienator and any persons related to or connected with him owned, less than 10 per cent of each class of the share capital of the company; or
  + (b) in the case of an interest in a partnership or trust, where immediately before the alienation of the interest, the alienator was entitled to, or the alienator and any persons related to or connected with him were entitled to, an interest of less than 10 per cent of the income and capital of the partnership or trust.

7. For the purposes of paragraph 5 of this Article:

* + (a) the term "an approved stock exchange" means a stock exchange prescribed for the purposes of the Canadian Income Tax Act or a recognised stock exchange within the meaning of the United Kingdom Corporation Tax Acts; and
  + (b) the term "immovable property" does not include any property (other than rental property) in which the business of the company, partnership or trust was carried on.

8. Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3, 4 and 5 of this Article shall be taxable only in the Contracting of which the alienator is a resident.

9. The provisions of paragraph 8 of this Article shall not affect the right of a Contracting State to tax, according to its domestic law, gains derived by an individual who is a resident of the other Contracting State from the alienation of any property, if the alienator:

* + (a) is a national of the first-mentioned Contracting State or was a resident of that State for 15 years or more prior to the alienation of the property; and
  + (b) was a resident of the first-mentioned Contracting State at any time during the five years immediately preceding such alienation.

|  |
| --- |
| Kubicek v The Queen 97 DTC 5454 (FCA) |
| TP purchases cottage in CAN (TCP) Sept 19 1968, his wife dies in 1981 making him the sole owner and under the treaty in 1992 was immovable CAN property . Dies in 1992, and is deemed to have disposed of it for FMV. Disagreement over what portion of the gain is taxable in Canada. TP wants it to start at purchase date (as he will get foreign tax credit from the US) MNR wants the reference point to be Dec 31st 1971, as capital gains tax started at the beginning of 1972. |
| Issue: when is the starting date for determining the Canadian tax consequences of a gain? |
| 🡪 purely a question of how to split tax revenue between Can/US |
| Held: for MNR |
| court looks at technical explanation |
| * + the context of the term “held” in the technical explanation would be literally accurate in endorsing a 1968 start date, but in the context of the technical explanation, the only gains referenced are those subject to tax, which in the Canadian context is only the gains after Dec 31st 1971 |
| meaning of “gain” isn’t defined in TT, therefore use def’n in domestic law   * + no def’n in ITA either, only a formula for calculation   + therefore, the meaning should be those gains which are subject to tax   + since Canada didn’t tax CG before 1972, gains should be calculated from when they became taxable |
| since the purpose of tax treaties is to avoid double taxation, there is no justification in taking into account the gains prior to Dec 31 1971  **RATIO: CG are taxable from the point they became taxable in Canada onwards (dec 31, 1972)** |

|  |
| --- |
| Placrefid Ltd v MNR 92 DTC 6480 FCTD |
| ~~Corp incorporated in Panama, head office in Switzerland, all D’s in Switzerland. Corp was created to salvage a Montreal investment. P was going to buy half an interest in the MTL investment once Century Plaza had given the whole thing to Mirlaw. Subsequent letter in which P wants to buy the whole thing, and the purchase price would cover Mirlaws cost, if Mirlaw changes its mind and doesn’t want to sell, they have to pay P. Mirlaw changes its mind, cancels agreement and pays P 250,000%. M considers that amount taxable and withholds 25% tax on the assumption that P has disposed of TCP and would be taxable in CAN. P files a return and claims a refund and says they shouldn’t have to pay tax in CAN. RA says they have disposed of TCP.~~  TP brought in to salvage investment in Montreal real estate venture (developer going belly-up, lender looking to foreclose🡪investors would lose all their equity in the property). Incorporated corp for this purpose in Panama, but all director meetings held in Switzerland.  TP ultimately signs deal with lender to buy any rights it may acquire through litigation. Under the deal, TP pays $250K up front. If lender (Mirlaw) cancels, it must return the $250K, plus pay a $250K cancellation fee. Lender cancels, and has to pay.  CRA feels $250k is PoD, and assesses $250k TCG (after deduction of $25k costs) under s.116 (selling an option in TCP).  TP appeals, doesn’t think it should be paying tax in Canada. |
| Issue: did P dispose of TCP? |
| Held: for TP |
| TP argues not CG, but AINT. No ITA s.2(3) tax (no CoB in Can). Alternatively, even if CoB in Canada then exempt under Can-Swiss TT VII(1) (exempts source tax for AINT for non-res with no PE).   * + CRA counters that cancellation fee was the disposition of an option in respect of TCP   + Even if not an option, AINT still CoB in Canada   + Also, no Can-Swiss treaty as res of Panama, not Switzerland   + Also, art. VII doesn’t apply to an option in respect of immovable property |
| Court   * + NOT a CG     - Mirlaw didn’t own the property, just a hypothec (ie. mortgage) and was suing for ownership     - Therefore Mirlaw had no property rights, so couldn’t legally grant an option       * (can’t sell an option on something that you don’t actually own)   + Resident of SWITZERLAND     - Even though incorporated in Panama, place of effective mg’t was Switz (all board meetings there)   + Not AINT, but IS CoB.     - Purpose of dealings was salvaging real estate investment (incorporated for this very purpose)     - Therefore $250k payment, which was directly related to this purpose, cannot be separated from other deelings to be treated as an AINT     - Therefore was part of the TP’s larger CoB in Canada   + No PE     - TP had an agent in Can, which CAN constitute a PE but only if it is a DEPENDENT agent.     - Agent did not have power to habitually conclude K, so no dependent agent PE for purposes of Can-Swiss Art V(4)   🡺 therefore, TP was CoB not through a PE, so exempt from source tax under Can-Swiss TT |

|  |
| --- |
| Beame v The Queen 2004 2 CTC FCA |
| TP is an Irish resident who owns shares in a Canadian company (TCP). He went and got a section 116 certificate in contemplation of his disposition on the basis that his tax liability amounted to 15% of his taxable capital gain on disposition ( the amount above the adjusted cost base). TP sold, got 8.25 million and 6.188 of that was taxable. MNR assessed on the fact that TP owed 15% of the entire amount, not just the taxable CG. |
| Issue: does the word “income” in part VI of the treaty mean entire gain or just taxable? |
| Held: for the TP |
| Reading in context of 115(1) and 2(3), then only the taxable portion of a CG is included in the TP’s taxable income earned in Canada |
| MNR says because 9(3) excludes capital gains explicitly, this means that “income” here includes the entre gain- court doesn’t like, says no merit |
| Only taxable capital gains are included in TP’s income . |



# CHAPTER 7: Income from Property

Part XIII

Main charging provisions are 212(1) and (2) which subject non residents to a tax of 25% on certain amounts that a person in Canada pays or credits the non resident

In addition 212 (5.1) puts a 23% tax on non resident actors for services in a Canadian film or video

Generally these apply to income from a passive investment, easier than getting all the non resident investors to file tax returns

215 imposes an obligation to each person who pays or credits a taxable amounts to non residents

#### ITA 212(1)

every non resident person shall pay an income tax on 25% on every amount that a person resident in Canada pays or credits , or is deemed by Part I to pay or credit , to the non-resident person as, on account or in lieu of of payment, oor in satisfaction of (FOR OUR PURPOSES)

* + (a) management fees
  + (b) NAL interest
    - interest that is not fully exempt , and is paid by a person whom is NAL to the T P
    - is participating debt interest
  + (d) rents, royalties or similar payment
    - note s Part XIV 219- Branch tax

#### ITA 212(2)

every non resident person shall pay an income tax of 25% on every amount that a corporation resident in Canada pays or credits, or is deemed by Part I or Part XIV to pay or credit, to the non-resident person as, on account or in lieu of payment of, or in satisfaction of,

* + (a ) a taxable dividend
  + (b) a capital dividend

#### ITA 212(4)

for the purposes of 1(a) “management or administration fee or charge” does not include any amount paid or credited or deemed by Part I to have been paid or credited to a non resident person as, on account or in lieu of payment of, or in satisfaction of

* + (a) a service performed by the non resident, if at the time of service
    - (i) the service was performed in the ordinary course of business of the non resident and
    - (ii) the non resident and the payer were at arms length
  + (b) a specific expense incurred by the non resident person for the performance of a service that was for the benefit of the payer

to the extent that the amount so paid or credited was reasonable in the circumstances

#### ITA 212(13)

where a non resident pays or credits an amount as, on account, or in lieu of payment or in satisfaction of

* + (a) rent for the use in Canada of property
  + (b) a timber royalty
  + (c) a payment of superannuation or pension benefit under a registered pension plan or of a distribution to one or more persons out of or under a retirement compensation arrangement
  + (d) a payment of retiring allowance or death benefit to the extent that the payment is deductible in computing the payers income
  + (f) interest on any mortgage, hypotecary claim or other indebtness entered into or modified after March 31 1977 and secured by real property situated in Canada or an interest therin to the extent that the amount so paid or credited is deductible in computing the non resident persons taxable income earned n Canada or the amount on which the non resident person is liable to pay tax under Part I.

the non resident person shall be deemed in respect of that payment to be a person resident in Canada

13.1

* + deals with when payer or payee is a partner ship

13.2

* + where non resident operates in Canada

13.3

* + foreign bank deemed to be resident
    - in any amount paid or credited in respect of its Canadian banking business and
    - any partnership interest held by the bank in respect of its Canadian banking business

#### ITA 215(1)

when a person pays, credits or provides, or is deemed to have paid, credited or provided a n amount on which income tax is payable , the person shall, notwithstanding any agreement or law to the contrary, deduct or withhold from it the amount of the tax anf forthwith remit that amount to the Receiver General on behalf of the non resident person on account of the tax and shall submit with the remittance a statement in prescribed form.

## Dividends and Repatriation of Branch Profits

non residents receiving dividends from companies resident in Canada are subject to a 25% withholding tax under 212(2)

* + the RESIDENCE of the company determines its source
  + so even if a non residence company derives most of its income from carrying on business in Canada, dividends paid by the company are no considered to have a Canadian source
    - makes sense, the corp would be taxed on that income

for purpose of non resident withholding tax, dividends also include benefits conferred by a corporation on its shareholders and deemed dividends arising from non arms length sales of shares of a Canadian corporation in a surplus stripping situation

#### ITA 212(2)

every non resident person shall pay an income tax of 25% on every amount that a corporation resident in Canada pays or credits, or is deemed by Part I or Part XIV to pay or credit, to the non-resident person as, on account or in lieu of payment of, or in satisfaction of,

* + (a ) a taxable dividend
  + (b) a capital dividend

#### ITA 214(3)(a)- PROBABLY DON’T NEED TO WORRY

for the purposes of this part,

(a) where section 15 or subsection 56(2) would, if Part I was applicable, require an amount to be included in computing a taxpayers income, then , that amount shall be deemed to have been paid to the taxpayer as a dividend from a corporation resident in Canada

* + s 15(1) benefit conferred on a shareholder .
    - where at any time in a taxation year a benefit is conferred on a shareholder, or on a a person in contemplation of that person becoming a shareholder, by a corporation otherwise by
      * (a) reducing the PUC , the redemption, the cancellation or acquisition by the corporation of shares of tis capital stock or winding up
      * (b) the payment of a dividend or stock dividend
      * (c) conferring on all owners of common shares of capital stock an equal right to buy more shares and
        + the voting rights of the particular class of common shares differ from the voting rights attached to another class of common shares and
        + there are no differences between the terms and conditions of the classes of shares that could cause the FMV if a class of shares to differ materially than from another class
      * the shares of the particular class shall be deemed to be property that is identical to the shares of the other class
      * rights are not considered identical if the cost of acquiring the rights differs or
      * (d) the amount or value shall be included in computing the income of the shareholder
    - 56(2) indirect payments
      * a payment or transfer of property made pursuant to the direction of , or with the concurrence of , a taxpayer to some other person for the benefit of the TP or as a benefit that the taxpayer desired to have conferred on the other person (other than pension plan) shall be included in computing the income of the taxpayer to the extent that it would have been made to the taxpayer

#### ITA 212.1

Non- arms length sale of shares

(1) if a non resident person, a designated partnership or a non resident owned investment corp disposes of shares of any class of the capital stock of a corporation resident in Canada to another corporation resident in Canada with which the non resident person is NAL, and immediately after disposition the subject corporation is **connected** with the purchaser corporation

* + - if non-res person disposes of shares in a Canco to another Canco NAL with non-res person AND the two Cancos are connected, then:
  + (a) the amount if any by which the FMV of any consideration (other than share of purchaser corp) received by the non resident person from the purchaser corp for the subject shares exceeds paid up capital in respect of the shares immediately before the disposition shall be deemed a dividend paid) by the purchaser corp to the non resident person
    - Deemed Dividend = amount of FMV-PUC (prevents stripping surplus as CG)
  + (b) if you get shares back ,the the PUC of the shares is “ground” down to the original value
    - decrease PUC by amount sale increased it

*ITA 219*

Branch tax

tries to duplicate withholding tax on sub to parent when the sub is making income in Canada and not reinvesting

if not reinvesting, subject to 25%

* + unless its transportation of goods, communications or mining in Canada

#### ITA 219.2

limitation on branch tax – Means that the treaty trumps ITA withholding rate

notwithstanding any other provision of this act, where an agreement or convention between the government of Canada and another country

* + (a) does not limit the rate of tax under this part on corporations resident in another country and
  + (b) provides that , where a dividend is paid by a corp resident in Canada to a corp resident in that other country that owns all of the shares of the capital stock of the corporation resident in Canada, the rate of tax imposed on the dividend shall not exceed a specific

any reference in section 219 to a rate shall, in respect of a taxation year of a corp to ehich that agreement or convention applies on the last day of that year, be read as a reference to the specified rate.

#### ITA 82(1) and 121

82(1) taxes dividends and 121 allows deductions for taxable dividends

because 82(1) applies to any individual, there can be may layers of tax between parent and sub companies

121 allows an exemption for inter corporate dividends

* + prevents multiple taxation

PROBLEM

* + If you make a holding company for your investments you can defer tax, so government introduved part IV tax

#### ITA 186

Imposes a 33% tax on private, closely held corporations UNLESS it is

(2) controlled corporation

* + one corp is controlled by another if more than 50% of its issued share capital belongs to that corp, or persons whom with they are NAL

(4) corporations connected with

* + a payer corporation is connected with a particular corporation at any time in a taxation year if
    - the payer corp is controlled by the particular corp
    - the particular corp owned at that time
      * more than 10% of the of the issued share capital ( with full voting rights) of the payer corp
      * more than 10% of the FMV of all the issued shares of the capital stock

Paid Up Capital

IDEA: any after-tax dollars you invest into a corp you should be able to take back out tax-free. However everything else in the corporation is income, and should be taxed.

* + Ex: If you put $10 into corp one year, and take $100 the next, the first $10 is PUC (so taken out tax free), while the rest is income (should be taxable somehow)
    - S. 84(3) exists to deem these amounts a dividend, whereas otherwise they would be a CG

if value of 10$ share goes up to $100, three options to get the money out.

* 1. TP could get paid a dividend
     + Taxable as a normal dividend
  2. TP could sell share back to corp.
     + In this case, 84(3) deems a dividend for the difference between the amount paid minus the PUC, which is taxable like in a) 🡪 this includes any tricky variants using NAL parties.
     + \*\*note: PUC is averaged across the entire share class.
  3. or could just sell the share to an AL third party
     + taxed as capital gain. However PUC still doesn’t increase, so if purchaser turned around and performed b), 84(3) would kick in the same way.

Surplus Stripping

CG and dividend rates differ, and there was no CG tax until 1972

* + Creates incentive to surplus strip, and change dividends into CG

In 1972 , when CG tax began, this problem was reduced

In 1984, with CG exemption, this problem happened again

* + So 84.1 was created, and international counterpart in 212.1
  + If you sell shares to a corp and get cash (or non share property) and this corp is connected to the first , that corp can get a connected corp dividend under part IV

What are we trying to prevent

* X (US resident) buys 10$ of shares of corp A and their value increases to 100$
* X sells shares to corp B, and is NAL with corp B
  + Gets 100$ cash only taxable at the CG rate
    - 90$ of that is a deemed dividend now
  + Gets 100$ of shares
    - This is the problem, because he technically gave 100$ in consideration for them so their PUC is 100$, he could sell them without having a dividend deemed and strip surplus!!!
      * SO, the rules do a PUC grind on these shares and deem their PUC to be 10$ so if non resident man were to sell them… what would happen?
        + The TP would want it to be a dividend
        + But could be a CG?

212.1 says

* + if you are NAL with the PURCHASER corp, and you are paid in cash
    - then the cash is deemed to be dividend to the extend that it
  + you could take shares back instead of cash
    - Then the PUC of those shares would be 100$ instead of 10
    - So the rules here grind the PUC down to the original PUC so if you redeem these shares there is a deemed dividend
  + Need a NAL person to the PURCHASER corp
    - 251(1)
    - related persons(a) and then a question of fact
  + 212.1(3) has deeming rules
    - (a) non resident deemed NAL if you have 5 or fewer people that control each of the corps
    - before: 1+ 4 others control first (subject and the corp)
      * after: 1+4 others control the purchaser corp
    - (b) add up shares if children and spouses and corps are controlled by them to see if they are one of 5 that controls the corp

#### Article 10 OECD

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

* + Residence jurisdiction on dividends received

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but **if the beneficial owner** of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

* + a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
  + b) 15 per cent of the gross amount of the dividends in all other cases. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations.This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.
    - Source jurisdiction allowed – if the beneficial owner is in the US
      * If BO owns 25%- 5% tax
      * If BO owns less- 15%

3. The term “dividends” as used in this Article means income from shares, “jouissance” shares or “jouissance” 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 the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State (source state), carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

#### Can- US Art X

1.  Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2.  However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State; but if a resident of the other Contracting State is the beneficial owner of such dividends, the tax so charged shall not exceed:

* + (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 per cent of the voting stock of the company paying the dividends;
  + (b) 15 per cent of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3.  The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is a resident.

4.  The provisions of paragraph 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article VII (Business Profits) or Article XIV (Independent Personal Services), as the case may be, shallapply.

5.  Where a company is a resident of a Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

6.  Nothing in this Convention shall be construed as preventing a Contracting State from imposing a tax on the earnings of a company attributable to permanent establishments in that State, in addition to the tax which would be chargeable on the earnings of a company which is a resident of that State, provided that any additional tax so imposed shall not exceed 5 per cent of the amount of such earnings which have not been subjected to such additional tax in previous taxation years. For the purposes of this paragraph, the term "earnings" means the amount by which the business profits attributable to permanent establishments in a Contracting State (including gains from the alienation of property forming part of the business property of such permanent establishments) in a year and previous years exceeds the sum of:

* + (a) business losses attributable to such permanent establishments (including losses from the alienation of property forming part of the business property of such permanent establishments) in such year and previous years;
  + (b) all taxes, other than the additional tax referred to in this paragraph, imposed on such profits in that State;
  + (c) the profits reinvested in that State, provided that where that State is Canada, such amount shall be determined in accordance with the existing provisions of the law of Canada regarding the computation of the allowance in respect of investment in property in Canada, and any subsequent modification of those provisions which shall not affect the general principle hereof; and
  + (d) five hundred thousand Canadian dollars ($500,000) or its equivalent in United States currency, less any amounts deducted by the company, or by an associated company with respect to the same or a similar business, under this subparagraph (d); for the purposes of this subparagraph (d) a company is associated with another company if one company directly or indirectly controls the other, or both companies are directly or indirectly controlled by the same person or persons, or if the two companies deal with each other not at arm's length.

7.  Notwithstanding the provisions of paragraph 2,

* + (a) dividends paid by a company that is a resident of Canada and a non-resident-owned investment corporation to a company that is a resident of the United States, that owns at least 10 per cent of the voting stock of the company paying the dividends and that is the beneficial owner of such dividends, may be taxed in Canada at a rate not exceeding 10 per cent of the gross amount of the dividends;
  + (b) paragraph 2(b) and not paragraph 2(a) shall apply in the case of dividends paid by a resident of the United States that is a Regulated Investment Company; and
  + (c) Paragraph 2(a) shall not apply to dividends paid by a resident of the United States that is a Real Estate Investment Trust, and paragraph 2(b) shall apply only where such dividends are beneficially owned by an individual holding an interest of less than 10 per cent in the trust; otherwise the rate of tax applicable under the domestic law of the United States shall apply. Where an estate or a testamentary trust acquired its interest in a Real Estate Investment Trust as a consequence of an individual's death, for the purposes of the preceding sentence the estate or trust shall for the five-year period following the death be deemed with respect to that interest to be an individual.

8.  Notwithstanding the provisions of paragraph 5, a company which is a resident of Canada and which has income subject to tax in the United States (without regard to the provisions of the Convention) may be liable to the United States accumulated earnings tax and personal holding company tax but only if 50 per cent or more in value of the outstanding voting shares of the company is owned, directly or indirectly, throughout the last half of its taxable year by citizens or residents of the United States (other than citizens of Canada who do not have immigrant status in the United States or who have not been residents in the United States for more than three taxable years) or by residents of a third state

#### Article 10

**Dividends**

1. Dividends paid by a company which is a resident of Canada to a resident of the United Kingdom may be taxed in the United Kingdom. Such dividends may also be taxed in Canada, and according to the laws of Canada, but provided that the beneficial owner of the dividends is a resident of the United Kingdom the tax so charged shall not exceed:

* + (a) 10 per cent of the gross amount of the dividends if the recipient is a company which controls, directly or indirectly, at least 10 per cent of the voting power in the company paying the dividends;
  + (b) 15 per cent of the gross amount of the dividends in all other cases.

2. Dividends paid by a company which is a resident of the United Kingdom to a resident of Canada may be taxed in Canada. Such dividends may also be taxed in the United Kingdom, and according to the laws of the United Kingdom, but provided that the beneficial owner of the dividends is a resident of Canada the tax so charged shall not exceed 15 per cent of the gross amount of the dividends.

3. However, as long as an individual resident in the United Kingdom is entitled to a tax credit in respect of dividends paid by a company resident in the United Kingdom, the following provisions of this paragraph shall apply instead of the provisions of paragraph 2 of this Article:

* + (a) (i) Dividends paid by a company which is a resident of the United Kingdom to a resident of Canada may be taxed in Canada.
    - (ii) Where a resident of Canada is entitled to a tax credit in respect of such a dividend under sub-paragraph (b) of this paragraph, tax may also be charged in the United Kingdom and according to the laws of the United Kingdom, on the aggregate of the amount or value of that dividend and the amount of that tax credit at a rate not exceeding 15 per cent.
    - (iii) Where a resident of Canada is entitled to a tax credit in respect of such a dividend under sub-paragraph (c) of this paragraph, tax may also be charged in the United Kingdom and according to the laws of the United Kingdom, on the aggregate of the amount or value of that dividend and the amount of that tax credit at a rate not exceeding 10 per cent.
    - (iv) Except as provided in sub-paragraphs (a)(ii) and (a)(iii) of this paragraph, dividends paid by a company which is a resident of the United Kingdom to a resident of Canada who is the beneficial owner of those dividends shall be exempt from any tax which is chargeable in the United Kingdom on dividends.
  + (b) A resident of Canada who receives a dividend from a company which is a resident of the United Kingdom shall, subject to the provisions of sub-paragraph (c) of this paragraph and provided he is the beneficial owner of the dividend, be entitled to the tax credit in respect thereof to which an individual resident in the United Kingdom would have been entitled had he received that dividend, and to the payment of any excess of such credit over his liability to United Kingdom tax.
  + (c) The provisions of sub-paragraph (b) of this paragraph shall not apply where the beneficial owner of the dividend is, or is associated with, a company which, either alone or together with one or more associated companies, controls, directly or indirectly, at least 10 per cent of the voting power in the company paying the dividend. In these circumstances a company which is a resident of Canada and receives a dividend from a company which is a resident of the United Kingdom shall, provided it is the beneficial owner of the dividend, be entitled to a tax credit equal to one-half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received that dividend, and to the payment of any excess of such credit over its liability to United Kingdom tax. For the purposes of this sub-paragraph, two companies shall be deemed to be associated if one controls, directly or indirectly, more than 50 per cent of the voting power in the other company, or a third company controls more than 50 per cent of the voting power in both of them.

4. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income assimilated to or treated in the same way as income from shares by the taxation law of the State of which the company making the payment is a resident.

5. The provisions of paragraphs 1, 2 and 3 shall not apply if the recipient of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State professional services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

6. Where a company is a resident of only one Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

7. If a resident of Canada does not bear Canadian tax on dividends derived from a company which is a resident of the United Kingdom and owns 10 per cent or more of the class of shares in respect of which the dividends are paid, then neither paragraph 2 nor 3 shall apply to the dividends to the extent that they can have been paid only out of profits which the company paying the dividends earned or other income which it received in a period ending twelve months or more before the relevant date. For the purposes of this paragraph the term "relevant date" means the date on which the beneficial owner of the dividends became the owner of 10 per cent or more of the class of shares referred to above.

Provided that this paragraph shall not apply if the shares were acquired for bona fide commercial reasons and not primarily for the purpose of securing the benefit of this Article.

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| --- |
| Placements Serco Ltee v The Queen |
| 212.1(1) made a share sale a DD  Issue: does 212(2) mention of “dividend” apply to “deemed dividend” as well?  Court:   * + 212(2)(a) applies not only to the actual payment of dividends, but to deemed dividends in which no payment of money has actually been made.   + **Dividend obviously means DD as well** |

|  |
| --- |
| Prevost Car Inc v The Queen [2008] DTC 3080 (TCC), and [2009] FCA |
| TP resident in Can, made busses in QB. Sold shares to companies in UK (Henleys 41%) and Sweden. (Volvo 51%) Under shareholders agreement, shares were transferred to co in the Netherlands (PHB.v), Netherlands withholding tax rate to Sweden was 5%, Can was 15% at the time. The shareholders agreement mandated that 80% of the profits were to be distributed to Volvo and Henleys. However, K was between V and H, so they had no claim against PHB.v if they failed to abide by this. Management board was allowed to accrue some profits. At all times, the dutch companies registered office was in Rodderdam and Amsterdam, had no employees or separate office in the Netherlands. Trent, a management company had substantial power. TP withheld tax on the basis that they were paying dividends to the holding company, resident in the Netherlands, at 5% under the treaty. MNR reassessed on the basis that that the BO of the dividends were the shareholders of the holding company (Volvo and Henley) |
| Issue: was the holding company merely a conduit? Who is the beneficial owner of the dividends paid by PC? |
| Held: for TP (FCA approved) |
| * TP argues the holding company not a conduit, that it is BO of the dividends |
| * + They couldn’t agree on keeping it in Sweden or England, but both wanted it to be in Europe |
| * + They wanted it because they each handled different parts of the operation and wanted to come together |
| * MNR says the holding company not the BO |
| * + Bases its position on *Indofood* |
| * + - Court of appeal did not look at contractual obligation to forward interest but rather at whether the recipient enjoyed the “full privilege” of the interest or was simply an “administrator of income” |
| * + - * In this case the issuer was obliged to pay the interest due to the noteholders one day before due date to account specified by the principle paying agent, and the principle paying agent is bound to pay the noteholders on the due date. Issuer gets no benefit |
| * Court : * “Beneficial owner” means the TRUE owner of the dividends, ie. the ultimate shareholders * HOWEVER, can’t lift the corporate veil (of the holdco) unless the “conduit company” has ZERO discretion not to distribute funds upwards |
| * + This is not a pure conduit |
| * + - Pure conduit |
| * + - * Had absolutely no discretion to decide what to do with the income |
| * + - * If all the income has to be paid out in dividend (and there is recourse if they’re not) |
| * + “beneficial owner” of dividends is the person who receives the dividends |
| * + - for his or her own enjoyment or use |
| * + - assumes the risk and control of the dividend received |
| * + - “the dividend is for the owners own benefit and this person is not accountable to anyone for how he or she deals with the dividend income |
| * + no evidence that holding co was a conduit |
| * + - holdco not a party to the shareholders agreement, therefore H and V could not take action if holding company didn’t follow dividend policy |
| * + does not want to pierce corporate veil if not a pure conduit |

|  |
| --- |
| RMM Canada Enterprises Inc v The Queen |
| US company called EC, with Can sub EL (has own sub ECL). EC acquired by US public company (Itel), didn’t want CAN subs. Business was winding up. EL and ECL had a portfolio of leases worth 100-150 grand. EC wanted to get at EL/ECL’s cash, but didn’t want to pay w/holding tax to wind up (s. 84(2) DD + 212(2)(a) w/holding tax for div paid to non-res). Company called RMM formed by (allegedly AL) 3rd party. Bought EL’s shares, wound up companies into itself, took some $$ out and paid out rest to EC for purchase price.  MNR reassess on the basis of 10% withholding tax on the basis that should have been a dividend. 212(2) taxing provision, and 212.1(1) /84(2) makes it a deemed dividend, or alternatively with the GAAR. |
| Issue: does 84(2) apply? |
| Held: for MNR |
| * 84(2) have the funds or property of the corporation been distributed “in any manner whatsoever”? |
| * + TP said that the loan used to close the transaction was not money from the corporation, but rather from the bank |
| * + Court says it doesn’t matter, as the loans from EL were used to secure, so it was indirect |
| * + The brief detour of the funds through RMM is not enough to change character |
| * + - They were funds of EL appropriated for the benefit of EC |
| * + There was a deemed dividend received by EC equal to the amount distributed over the PUC |
| * 212.1(1) application |
| * + do RMM and EC deal at arms length? |
| * + - MNR says NAL |
| * + - 251(1)(b) |
| * + - * means that if persons are unrelated, the factual underpinning of their relationship must be ascertained |
| * + - * criteria from *McNichol* |
| * + - * + exisetence of common mind |
| * + - * + parties acting in concert without separate interests |
| * + - * + “de facto” control |
| * + court says NAL |
| * + - common mind |
| * + - * they premature payment of the guaranteed amount, the endorsement of refund cheques and the fact that RMM essentially disappeared after it served its purpose means that it had no independent role         + Even though independently bargained for the deal, it was essentially a plan for RMM to execute EC’s intentions 🡪 therefore NAL       * EL had been winding down for 5 years before purchase, and RMM had no intention of CoB through it.         + Further, all leases owned by EL were immediately signed over to EC. |
| * GAAR Application   + Scheme fails under 84/212, but if court is wrong says GAAR would apply to recharacterize xact to make 84/212 apply |
| * + Obvious tax benefit |
| * + Bona fide business purpose |
| * + - Entire thrust of EC’s endeavors was to save Canadian withholding tax     - No BF bus purp. |
| * + Abuse/misuse |
| * + - ITA read as a whole envisions that a distribution of surplus to shareholders is to be taxed as a payment of dividends . a form of transaction that is otherwise devoid of any commercial purpose , and that has as its real purpose the extraction of corporate surplus and the avoidance of the ordinary consequences of such a distribution, is an abuse of the ITA as a whole. * US-Can Treaty art. XII   + Resident state taxation only for “alienation” of property (ie. CG)   + TP argues this gives only the US jurisdiction to tax   + COURT:     - No 🡪 XII only applies to genuine alienation, not bullshit tax avoidance schemes     - If CG deemed a dividend, then that meaning extends to TT 🡪 no alienation, just a dividend |



###### PART III: TAXATION OF RESIDENTS ON FOREIGN SOURCE INCOME

# CHAPTER 8: Relief from double taxation

## Exemptions

#### ITA 110(1)(f)

Treaty exemption

(1) for the purpose of computing the taxable income of a TP for a taxation year, there may be deducted such of the following amounts that are applicable

(f) deductions for payments (ie. income)

* + (i)an amount exempt from income tax in Canada because of a provision contained in a tax treaty with another country that has the force of law in Canada
  + (iii) income from employment with a prescribed international organization
  + (iv)the taxpayers income from employment with a prescribed international governmental organization where the TP…
    - was not at any time in the year a Canadian citizen
    - was a non resident person before immediately beginning that employment in Canada and
    - if the TP is resident in Canada solely for the purpose of the employment
    - **(prescribed int’l organizations is mostly UN agencies / int’l anti-doping agency)**

#### Reg 8900

for the purposes of the 110(f)(1)(iv) the following international organizations are prescribed

* + the United Nations
  + each international organization that is a specialized agency brought into a relationship with the UN in accordance with Art 63

#### ITA 126(3)

Employees of international organizations

where an individual is resident in Canada at any time in a year, there may be deducted from the individuals income an amount that relates to the amount of their income from an international organization

#### ITA 122.3

Overseas Employment Tax Credit

provides a tax credit to **individuals** who are resident in Canada and working abroad for a specified employer in connection with contracts for certain defined activities

* + credit equal to the lesser of 80,000 or 80% of overseas income of total income for the year
  + intent is to make it easier for Canadian employers to recruit Canadians for foreign jobs and to be competitive on bidding for foreign projects.

Criteria that must be met

* + (a)employed by a **specified employer** OTHER than for the performance of services under a prescribed international development assistance program of the government of Canada
    - Specified employer 122.3(2) must be
      * Resident in Canada
      * A partnership at least 10% owned by residents of Canada (according to FMV of interests)
      * A foreign affiliate (as defined in 95(1))
  + (b) performed duties all or substantially all (usually means >90%) outside of Canada
    - in connection with **defined contractual activities** (one or more K’s) of the employer
      * exploration for or exploration of petroleum, natural gas, minerals or other similar resources
      * any construction installation, agricultural or engineering activity
      * any prescribed activity
        + part LX of regulations prescribes an activity carried out under a contract with the united nations
    - for the purpose of obtaining a contract for the employer to carry out such activities
    - \*\*\* individual must perform all or substantially all outside of Canada, but there is no requirement that the employment be outside Canada throughout the period – *Rook v. R*\*\*
    - for a period of 6+ consecutive months

does NOT require that he specified employer be the main or prime contractor of any qualifying project outside of Canada

* + Gonsalves v R [2000] TCC

Calculation of Overseas Employment Credit

General rule: lesser of 80,000 or 80% of qualifying overseas income is of his/her total income for the year

Credit = TOP x [ (lesser of C or D) / E ]

* + C: $80k x (length of “qualifying period” that resident in Canada / 365 days)
    - ~ 80k x % of year res in Canada
  + D: 80% of income reasonably attributable to qualifying period in which res. in Canada
    - ~ 80% of income while res. in Canada
  + E: total income if res. in Canada all year
    - Sum determined by s.114(a)
    - Implied that it is net income (ie. allowing for available deductions, though only for the overseas part of the income)

Excluded income

122.3(1.1) – excludes ~PSB from 122.3

provides that no amount may be included under paragraph 122.3 1(d) in respect of an individuals income for a taxation year from the individuals employment by an employer when:

* + the employer carries on the business or providing services
  + the employer does not employ more than 5 full time employees
    - if has 6 doesn’t apply *R v Hughes & Co Holdings Ltd*
  + individual does not deal at arms length with the employer , or is a specified shareholder
    - specified shareholder = owns at least 10% of a class of shares in the corp or a related corp (248)(1)

|  |
| --- |
| Rooke v the Queen |
| TP was resident of Canada and an employee of an AB corp that met the defn of “specified employer.” Work was done in connection with his employers contracts outside of Canada, and related to engineering. He does the engineering work outside of Canada (but is never outside for more than 3.5 months at a time). When in Canada, only does bookkeeping work. TP argues that he should get credit, RA says he fails because never outside Canada for the qualifying period. |
| Issue: interpretation of 122.3(2) |
| Held: for TP |
| * agreed that |
| * + TP resident in Canada |
| * + Employed by “specified employer” |
| * + Employment was for something other than the performance of services under a international development program |
| * + All or substantially all of duties were performed outside of Canada |
| * Disagree on the 5th (since repealed requirement) |
| * + (e) conditions 2, 3,4 subsisted for a period of more than 6 consecutive months in the year, or beginning or ending in a year , through which whe was “employed outside Canada” |
| * + - crown: every time TP came back to Canada he ended a qualifying period |
| * + - * this reads in “employment outside of Canada” must be sustained during the qualifying period |
| * + - * says that because TP was not continuously employed outside Canada for 6 months |
| * + - court: says that the only location requirement to be read in here is that all or substantially all of the employment duties must be performed outside Canada during the qualifying period       * ie. it is not the CONTRACT that must last the qualifying period, but the EMPLOYMENT.       * “all or substantially all” of the TP’s duties were outside Canada, and he was employed by his company throughout the year. |

## Foreign Tax Credit and Deductions

s 126 ITA adopts a tax credit method for relieving double taxation

income taxes paid to the Canadian government are reduced (or credited) by the amount of income taxes paid to foreign governments

essentially taxes foreign income no differently than Canadian and then allows a credit against Canadian tax liability for foreign taxes

if foreign tax rate differs

* + the credit is capped by the amount of Canadian tax otherwise payable

this method is elective

* + can also choose a deduction under 20(12)

LIMITS

* + Applicable foreign taxes paid
  + Amount of Canadian tax otherwise payable
  + Ordering
    - NBIT deducted first (IT- 270R3)
    - Allows TP to maximize their credit claims over the years, as only the portion of BIT that is not deductible as a foreign tax credit for the year can be carried over for purposes of a foreign tax credit in other years
  + Credits can only be used in years where TP COB in a foreign company

NOTE: s.126 doesn’t apply to income from FA’s (s.113 rules apply instead) 🡪 s.113 > s. 126

#### ITA 126(1) -NBIT

Foreign Tax Deduction

person resident in Canada may deduct an amount equal to

(a) NON BUSINESS INCOME TAX paid to a government other than Can

* + employment, CG, income from property other than stuff under 20(11), real property
  + not exceeding tax otherwise payable

#### ITA 126(2) - BIT

Where a TP who was resident in Canada at any time in a taxation year CoB in the year in a country other than Canada, the TP may deduct from the tax otherwise payable in this part by the TP

BUSINESS INCOME TAX

#### ITA 20(11)

Foreign taxes on income from property exceeding 15%

Resident can deduct any amount by which

* + (a) income or profits tax paid by the TP to the government of a country other than Canada for the year as can reasonably have been included in calculating the TP’s income exceeds
  + 15%
  + \*\*\* so the first 15% gets foreign tax credit, then can deduct the rest under this \*\*

#### ITA 20(12)

Foreign non-business income tax

provides for the deduction of NBIT paid to a foreign government in respect of a business or property

#### ITA 110.5

Additions for foreign tax deductions

there shall be added to a corporations taxable income otherwise determined for a taxation year such amount as a corporation may claim to the extent that the addition thereof

* + (a) increases the amount deductible by the corporation under subsection 126(1) or 126(2) for the year

Other advantage: any amount added under this section gets added to the TP’s non capital losses

* + Carried back 3 years
  + Carried forward 20 years
  + Deduct against any source of income

#### ITA 111(8)

Defines non capital loss

Adds the amount, if any, determined under 110.5

#### ITA 126(4)

Portion of foreign tax not included

an income or profits tax paid to a foreign government that would not get if they were a resident (ie under 113) are not included for the purposes of 126

#### ITA 126(7)

Definitions

business income tax

* + means the portion of any income or profits tax paid by the TP for the year to the government of a country other than Canada that can reasonably be regarded as tax in respect of the income of the TP from a business carried on by the TP in the business country. Does not include
    - amount person or partnership has or is entitled to receive from that government
    - an amount deductible under a treaty exemption (110(1)(f)(i))

non business income tax

* + defined by exclusion – includes any foreign income or profits tax that is not included in foreign business income tax and is not deductible under 20(11)
    - includes: taxes on employment income, capital gains, passive investment income ( dividends, interest, rent, royalties)

tax exempt income

* + TP entitled to an exemption because of a tax treaty to all income and or profits tax in that country
  + No income or profits tax to which the treaty does not apply is imposed in any country other than Canada

##### Is it an Income or Profits tax ?

Essential features

* + Taxes are extracted under the compulsion of law
  + The money in question must be collected as revenue to be used for general public or government purposes
    - Different from licenses or fees that confer a particular benefit or privilege
  + Must be an income or profits tax
    - Income must have a source under s3
    - Ex gambling winnings in the US, taxable there, but not creditable in CAN
      * *Dagenais v Canada* 
        + Foreign tax paid on income from a source that is not included in computing income under the act is not income tax
    - Income refers to a “net” system
    - If foreign tax calculated on a gross basis but can produce a reasonable approximation of actual net income in typical situations it will be accepted (and if an actual computation of net income would be affected by arbitrary calculations)
    - CG are taxable under ITA , so they count for credit even if the foreign country taxes them under a separate statute
    - NOT INCLUDED: sales taxes, succession duties or inheritance taxes, property or real estate taxes, franchise or business taxes, customs or import duties, gift taxes

|  |
| --- |
| Yates v GCA Int Ltd (Chancery Division) |
| Whether or not Venezuelan tax on 90% gross receipts was a tax on profit- appeared to be tax on gross receipt, but on consideration of taxing statute the court found the tax to be a tax on estimated net income |
| Tax qualified |

|  |
| --- |
| Lai v MNR [1980] TRB |
| TP’s owned buildings in Hong Kong, taxing authorities imposed a tax on building and landowners at 15% of the rent value. In assessing this tax payable, a deduction was allowed for expenses and maintenance   * + Surrogate tax on rent 🡺 therefore an I/P tax |
| Tax was held to be creditable |

|  |
| --- |
| Kempe v The Queen 2001 1 CTC 2060 TCC |
| TP was from Germany , became resident of Canada. Had German income, paid tax in Germany, which has church tax- if you are member of church you were subject to this tax. TP and wife were church members. Church tax is a surtax (tax on tax, which is indirectly tax on income) collected by and paid to the German government, who takes a management fee and then pays the church. TP tries to deduct as a foreign tax credit. |
| Issue: Is church tax a foreign income or profits tax? |
| Held: for TP |
| Court says it IS a tax |
| * + It is imposed by legislature |
| * + Is compulsory |
| * + - That is can be avoided by giving up citizenship or church membership doesn’t make it any less a tax |
| * + - Collected by and paid to the German government |
| * + For a public purpose |
| * + - Not a service fee |
| And it IS an income tax |
| * + Calculated as a percentage of income or wage tax |
| * + - Being superimposed on an income or wage tax does not change its essential character |

##### Non Business Income Tax

Calculation for 126(1):

CTOP(NBIT) = FNBI/World Income \* CTOP(from s.127(7))

CTOP(NBIT) 🡺 Can TOP as it pertains to can. tax on income from **this** source

* + - * + Calc done for each individual foreign country

FNBI 🡺 from s.126(1)(b)(i)

* + - * + generally assumes that NO business carried on in source country
        + includes income deemed to be from that country
        + doesn’t include tax-exempt income (due to s.126(7) def’n of NBI)

ITA 126(7)

* + includes: taxes on employment income, capital gains, passive investment income ( dividends, interest, rent, royalties)

ITA 20(11)

* + Foreign taxes on income from property exceeding 15%
  + Resident can deduct any amount by which
    - (a) income or profits tax paid by the TP to the government of a country other than Canada for the year as can reasonably have been included in calculating the TP’s income exceeds 15%
    - \*\*\* so the first 15% gets foreign tax credit, then can deduct the rest under this \*\*

effect of 126(&) and 20(11)

* + income or profits tax paid by an individual to the government of a country other than Canada in respect of income from property (other then real property) from a source outside Canada may only be claimed as a foreign tax credit for a foreign tax rate of up to 15%- any balance may be allowed in deducting income
  + therefore 20(11) limits foreign tax credits

ITA 20(12)

* + Any TP may claim a deduction in computing income in respect of NBIT and to the extent that the TP does so , the right to claim a foreign tax credit in respect of that amount is lost.
  + Thus this provision introduces a deduction instead of tax credit in limited cases
  + Expressly limited to foreign NBIT
    - DOES NOT extend to BIT
  + NBIT deducted under this section is excluded from NBIT for the purposes of 126(7)
    - So if you deduct using this you need to make an equivalent reduction in respect of the relevant foreign country of the NBIT eligible for foreign tax credits
  + NBIT paid in respect of employment NOT deductible under 20(12)
    - 8(2) restricts employment income deductions to those under 8
  + if foreign NBIT exceeds limitations, then use this to deduct the excess instead of using the credit

ITA 110.5

* + Allows a corporation to add an amount to its taxable foreign income
  + Makes worldwide income go up, but when you use the credits its is still beneficial
  + Also, this amount added can be added to non capital losses
    - 111(8) defines non capital loss
      * an amount determined under 110.5

##### Determining the Source of the Income

ITA

* + Generally silent
  + Treaties generally provide that if income earned by a Canadian resident is taxable in a country , that country will be deemed to be its source
    - Ex XXIV (3)(a) Can-US

CRA IT- 270R3

* + Business Income
    - Generally where the substance of the operations in substance take place
    - If a connected business is incidental it is not considered
    - If business is carried on in more than one country, reasonable allocation of the net income must be allocated
  + Employment income
    - Place where they normally perform the related duties
      * If part is in foreign country, they are subject to tax there are then credited
      * Split between countries usually based on # of days working there
    - Directors fees paid where meetings held
    - Commission earned where effort is expended
  + Income from property
    - Interest- residence of the debtor
    - Dividend- residence of the corp , unless treaty determines or 250(5) deems to be not in Canada
    - Rent of tangible property
      * Real property- where the property is located
      * Other tangible property- country where prop is used
    - Royalty payment- country in which the right is used or exploited

CRA IT- 395R

* + Capital gains and capital loss
    - Real property- location of property
    - Other capital property- where the sale took place
    - Deemed disposition- Canada, regardless of any other location
    - Stock or bond- location of securities or stock exchange
      * If not in one of these- then place of business of issuer

|  |
| --- |
| Dagenais v The Queen [2000] 2 CTC 2022 (TCC) |
| TP resident of Can, wins a lottery in the US, $112K. (Can does not tax lottery winnings under (40(2)(f))). US does tax and imposes a withholding tax. So US withheld 36 thousand. TP had shares in US and sold, got CG and was taxed in Can on this gain (US didn’t tax). TP wanted to offset the Canadian capital gains tax with foreign tax credit deductions from the lottery winnings. |
| Issue: is the tax on the lottery a NBIT and creditable under 126? |
| Held: for MNR |
| TP says 126(1) does not classify various CG taxes in the US according to how they are treated in Canada |
| MNR says that lottery gains are not taxable capital gains, and thus not income in Canada |
| * + The purpose of credits is to prevent double taxation, and that is not happening here |
| Court: “income can only have the meaning of income within the act” |
| * + Since gains were not included in computing income, there was no tax otherwise payable |

|  |
| --- |
| Interprovincial Pipe Line Co v MNR [1968] CTC 156 (SCC) |
| TP owned a pipeline between Can-US. Can part owned by TP, US part by wholly-owned sub Lakehead. Construction of US part was debt financed 🡪 parent borrowed the money in Can and lent to sub. Charged sub interest (~2.4m), and used that to pay off interest on the debt (~2.3m). Parent wrote off interest payments on the loan, but the US imposed a 15% withholding tax on the interest paid by the sub.  Tried to claim a credit on the full w/holding tax, but MNR said only w/holding tax on interest INCOME may be deducted. The income implies “net” income, ie. the difference between what it charged the sub and what it was charged by the bank (~57k). |
| Issue: where do you attribute the interest expense? |
| Held: for the MNR   * The section only allowed deductions for tax paid on INCOME. Thus only the w/holding tax attributable to the $57k is creditable (taxpayer gets completely fucked) * Article XV was of no help, because it was only binding as between the contracting parties (the states), and not between each state and the taxpayer. |
| Now they could deduct under 20 (12) whatever they are disallowed under 126(1), but this wouldn’t happen as there is no withholding tax |

##### Business Income Tax

Defined in 126(7) as the income of profits tax paid to the government of a foreign company which may reasonably be regarded as tax in respect of income from any business carried on in that country

* + Includes the income tax paid to all foreign countries which impose tax upon the income derived from carrying on a business in one particular foreign country.
    - Ex Can co COB in US might get taxed for its activities on Mexico, that would be counted.

Generally, a tax qualifies as BIT if:

* + It is a tax that can reasonably be regarded as being in respect of income from any business carried on by the TP in that country
  + It is a tax paid to any foreign jurisdiction

ONLY pertains to income outside of Canada- this is a question of fact

* + Source is generally where the operations in substance take place (IT -2790R3)
    - Real prop development and sale- where the prop is
    - Merchandise trading – where sales are completed (also look at where stock is and where payment)
    - Trading intangible prop- where purchase and sale decisions made
    - Money lending – where loan arrangement is in substance completed
    - Personal property rentals- the place where property available for rental is normally located
    - Service- where they are performed

If business does more than one of these, consider them separately for deciding where the business is being carried on

If business is carried on in more than one country, then may allocate to each country

Some taxes that would otherwise be BIT are excluded ….

* + amount person or partnership has or is entitled to receive from that government
  + an amount deductible under a treaty exemption (110(1)(f)(i))

… these can be deducted as NBIT under 20(12)

##### Excess Credit & Relief Measures

Excess Credit can happen if:

* tax rate is higher in foreign country than in Canada
* there is a difference in computation in the foreign country
  + Interprovincial Pipe Line
    - Net income was so small that could not use up the credits from the withholding tax
* There are losses in Canada or other jurisdictions so that when you calculate your worldwide income it is low

Relief measures

110.5 allows a corp to add to any extra amount in computing its income , to the extent that this causes an increase to any amount deductible by the corp as a foreign tax credit under 126(1) or 126(2) but does not cause any increase to certain other amounts deductible

* + under 111(8) this is added to the non capital losses, so can be carried forward for future taxation years

20(12) allows deduction of excess NBIT credit

* + - can deduct instead of take the credit
  + Restrictions:
    - Only applies to deductions after 1978
    - Only applies to NBIT (as defined by s.126(7), though leaving out (iii)-(iv) of that def’n)
    - For corporations, doesn’t apply to income from owning shares (capital stock) in a FA (ie. dividends caught by a w/holding tax).
      * Note: individuals can deduct here
    - Amounts are “as the TP claims,” but are limited to being deducted from income from source to which the tax relates.

Can carry BIT credits forward

* + 126(2) allows credit to be carried forward 10 years and back 3

## Dividends from Foreign Affiliates

#### ITA 90(1)

Dividends received from non- resident corporation

in computing the income for a taxation year of TP resident in Canada, there shall be included any amounts received by the TP in the year, as, on account or in lieu of, or in satisfaction of, dividends on a share owned by the TP of the capital stock of a corporation not resident in Canada

* + ALL DIVIDENDS are initially included in income (by corp OR individual)

The amount contemplated by section 90 is included in the TP’s income under 12(1)(k)

#### ITA 113(1)

Deduction in respect of dividend received from foreign affiliate

(1) where in a taxation year a corporation resident in Canada has received a dividend on a share owned by it of the capital stock of a foreign affiliate of the corporation, there may be deducted from the income for the year of the corporation for the purpose of computing its taxable income equal to

* + (a) EXEMPT SURPLUS: an amount equal to such portion if the dividend as is prescribed to have been paid out of the exempt surplus, as defined by regulation

**\* if paid from exempt surplus, then full deduction\***

* + - any foreign withholding tax that might apply to such a dividend is not creditable in computing Canadian income tax of the shareholder
    - “exempt surplus”= active business income of a foreign affiliate earned during the period in which the shareholder was a shareholder and the foreign affiliate is resident in a designated treaty country
  + TAXABLE SURPLUS (b) & (c) are partial deductions (that are really credits) giving you credit from underlying foreign tax and withholding tax on income paid out a taxable surplus
  + (b): applies to dividend paid out of the **“taxable surplus**” of the affiliate
    - an indirect foreign tax credit
    - provides a credit for the foreign corporate income tax paid by the foreign affiliate in respect of the income that funds the payment of taxable dividends
    - foreign tax up to the rate of the equivalent applicable Canadian tax is creditable, any residual tax ‘room’ is occupied by additional Canadian tax so that overall, the foreign income is taxable at least with a rate at least consistent with applicable Canadian tax rates
      * 5900(1)(d): def’n of “underlying foreign tax”
      * 5907(1): def’n of “underlying foreign tax applicable”
  + (c) applies to dividend paid out of the **“taxable surplus**” of the affiliate
    - a direct foreign tax credit
    - provides a credit, effectively, for non-resident withholding tax imposed on the dividend

\*\*\* Tax surplus= includes a foreign affiliates earnings from an active business carried on in a non treaty country (or the affiliate is not resident in the treaty country), FAPI, and any taxable portion of capital gains from the disposition of excluded property that is used or held principally for the purpose of earning inconme from an active business that is not carried on in a treaty country\*\*\*

* + (d) PRE-ACQ SURPLUS: an amount equal to such portion of the dividend as is prescribed to have been paid out of the pre-acquisition surplus of the affiliate

\* **full deduction for dividends paid out of pre acquisition surplus\***

* + - really a return of capital, so it is tax free
    - 92(2) says that if you use this deduction, you should reduce your adjusted cost base.

Effect of 113?

Completes the exemption from Canadian taxation of foreign active business income earned in a treaty country by exempting dividends paid out of such income

* + Dividends paid out of FAPI and business income in non-treaty countries are still taxable in Canada

If a dividend has been included in a TP’s income in accordance with s 90 and 12(1)(k) certain offsetting deductions are available

* + ANY TAXPAYER -Deduction in respect of dividends received out of the taxable surplus of a corporation that was at any time a **controlled** foreign affiliate of the taxpayer
    - Accounts for previously taxed FAPI
  + CORPORATE TAXPAYER-
    - deduction in respect of dividends received out of the exempt surplus of a foreign affiliate
      * 113(1)(a)
      * allows Can TP to receive dividends that are effectively free of tax from their foreign affiliates , as long as these dividends are derived from countries with which Canada has a treaty
    - deduction for dividend received out of the taxable surplus of a foreign affiliate
      * 113(1)(b) & (c)
      * dividend remains in corps income
      * deduction allowed in respect of the UNDERLYING income from which the dividend was paid- prevents double taxing at the ‘higher ‘corporate level
        + calculated by using the relevant tax rate in the foreign country and rate of withholding tax affecting the dividend itself
    - deduction for dividends received out of the pre-acquisition surplus of a foreign affiliate
      * 113(1)(d)
      * treats such a dividend the SAME AS A RETURN OF CAPITAL
      * dividend is excluded from the recipients taxable income, the cost to the recipient of the shares on which the dividend was received is reduced by the amount of the dividend
        + 92(2)(c)

##### Individuals

resident in Canada who are in receipt of a dividend from a corporation that is not resident of Canda must include the dividend in their income under 90(1) and 12(1)(k) AND

* + if the foreign corp was ever a controlled foreign affiliate
    - deduction for previously taxed FAPI under 91(5)
  + claim foreign tax credit under 126(1) for withholding tax
  + if foreign withholding tax exceeds 15%, the excess is deductible from income under 20(11)

##### Corporations 🡪 elaborated on in FAPI section

resident in Canada must include in its income all dividends received from a corporation not in Canada under 90 and 12(1)(k) AND

* + if the foreign corp was ever a controlled affiliate
    - then can deduct in respect of dividends out of previously taxed FAPI
  + if when dividend paid, it is a FOREIGN AFFILIATE and EXEMPT or PRE- ACQUISITION SURPLUS
    - entire dividend may be deducted in computing the Canadian corps income
    - 113(1)(a), (d)
  + If dividend paid out of TAXABLE SURPLUS
    - Amounts calculated using underlying foreign tax and withholding tax rates are deductible
    - 113(b)(c)
  + if you deduct under 113, then no foreign tax credit
  + If its not a foreign affiliate
    - Then credit may be obtained for the withholding tax

##### Calculating Taxable Surplus

Taxable portion of dividend = whole dividend – (b) deduction – (c) deduction

(b) = dividend x (foreign corporate tax rate)(relevant Canadian tax factor – 1)

(c) = dividend x (foreign withholding tax rate)( relevant Canadian tax factor)

\*relevant tax factor = 1 / base corp. tax rate: 2 for individuals, 2.6316 for corporations.

\*\* should work out the same as doing a credit (so just deducting foreign corp. tax and w/holding tax from CTOP)

#### Reg 5901(1) – ordering of surpluses

Deems order that dividends are paid from

1. EXEMPT SURPLUS: Dividends are to be considered to arise first out of exempt surplus,
2. TAXALE SURPLUS: When no exempt surplus, out of taxable surplus
3. PRE-ACQ SURPLUS: When neither, pre-acquisition surplus

#### Reg 5907(1) – surplus definitions

#### Reg 5900

* (1)Calculates how much of the dividend from a particular surplus account applies to each individual share in a class
* (1)(d): calculation for how much “foreign tax applicable” applies to each share in a class on the dividend from taxable surplus
* (2): allows Canco. To increase amount of dividend deemed paid out of taxable surplus (by decreasing the amount of exempt surplus).
  + Do this if there’s losses, so that you can carry forward the deduction?

##### What kind of surplus?

Dividend from treaty country…. EXEMPT -> 113(1)(a)

* + Includes TIEA’s as well as TTs

Surplus made while in control of the Foreign Affiliate (and not a treaty country)… TAXABLE SURPLUS - > 113(1)(b)(c)

If you bought the foreign affiliate partway through the year… Pre-ACQ surplus

* + Treated like a return of capital
  + ACB reduced by the amount of dividend

Policy behind 113

Traditional policy – when we had 8/9 treaties

* if carrying on an active business in a country with a treaty with can then the income from active business is exempt surplus
  + ceding jurisdiction to the source country where we had a treaty
  + all countries with high tax
  + made it simple
* active business in a non treaty country, low tax
  + if we gave a credit we would still collect tax in Canada because the credit would still be small so we should still be taxing to prevent incentive to set up business elsewhere
  + these rules did this

Now- have many treaties

* now everyone wants treaties because you cede Canadian tax jurisdiction
  + felt taxing was penalizing
* global taxation as a result of globalization has moved in this direction
* Canada has done this by expanding treaty network
* Instead of applying credit to foreign affiliates, we effectively make dividends exempt
* Then the gov’t said
  + If treaty or tax information exchange agreement they are exempt
    - Lowered the bar for exempting dividends
    - Policy has defacto shifted

##### Foreign Affiliate

Defined in s 95(1)

* + At any time, of a taxpayer resident in Canada means a non-resident corporation in which, at that time
  + (a) the taxpayers equity percentage is not less than 1% AND
  + (b) the total of the equity percentages in the corporation of the taxpayer and of each person related to the taxpayer is not less than 10%

##### Equity percentage and Direct Equity Percentage

Defined in 95(4)

Direct equity percentage: basically the highest percentage ownership of any class of shares in a company of the Canadian taxpayer

Equity percentage: sum of the direct equity percentage and indirect equity percentage

* + Indirect equity percentage= multiply the direct ownership in corp that has direct ownership in the foreign corp
  + There can be many levels, so just add them all together, this can equal more than 100%

##### Related persons to a corp

This is an issue in determining if you have a foreign affiliate, because the equity person of the TP and related persons must be 10% to meet that threshold

#### ITA 251

Individuals who are related

(1) (a)Individuals who are related: blood (draw the cross), marriage and adoption

Determining if corps are related

(2)(b) a corporation and

* + (i) controls the corp
    - means holds the right to elect the majority of the board of directors
    - 50% of votes is de jure control
  + (ii) person who is a member of a related group that controls the corp
    - 251(4) related group: a group of persons each member of which is related to every other member of the group
      * de jure control
  + (iii) any person who is related to (i) or (ii)

(2)(c) corp and corp

* + (i) if they are controlled by the same person or group of persons
  + (ii) if each of the corps is controlled by one person, and the person who controls one is related to the person who controls the other
  + (iii) if one of the corps is controlled by one person and that person is related to a related group that controls the other corp,

251(5)

* + deeming rules
    - (a) related group in position to control, but is in fact a part of larger group that contols, then deemed to control
    - (b) options and rights
      * if you have right to acquire shares or cause corp to redeem shares or reduce someone elses voting rights, you are DEEMED to be in the position as if you had exercised this right
      * means you can have multiple control groups

#### ITA 256 (6.1)

(a) where corp would be controlled by corp if it were not controlled by another person or group, then the sub is deemed to be controlled by the parent and any person who controls the parent (two controls)

(b) if you are controlled by a first tier group, you are controlled by anyone who controls the first tier group

##### Anti- Avoidance Rules

#### ITA 95(6)

Where rights or shares issued, acquired or disposed of to avoid tax

(a) where person or partnership has a right to, or to acquire, shares of a corporation and

* + (i) it can reasonably be considered that the principle purpose for the existence of the right is to to cause 2 or more corps to be related, then the particular corps are deemed not to be related
  + (ii) where it **can reasonably be considered** that the **principle purpose** is for the existence of the right is to permit any person to avoid, reduce or defer tax payable, or some other amount, under the act, the relevant shares are deemed to be owned by the person or partnership who enjoys the benefit of the right

\*\*\* this means 95(2)(a)- a FAPI deeming rule will not apply to re-characterize property income as active business income, and the relevant amounts that would otherwise benefit from this re-characterization will continue to be characterized as FAPI\*\*\*

(b) where a person or partnership acquires or disposes of shares, either directly or indirectly, if the principal purpose of the acquisition can reasonably be considered to be the avoidance, reduction, or deferral of tax payable or some other amount under the act, the relevant shares are deemed not to be acquired or disposed of as the case may be . Furthermore, where the shares were unissued before the particular acquisition, they are deemed not to have

been issued .

|  |
| --- |
| Univar Canada Ltd v The Queen[2006] 1 CTC TCC |
| TP international corporate group, with subs in US, EU, Can, etc. EU sub needs money, Can sub has lots. Can sub sets up Barbados sub, puts chunk of $$ in as PUC, which gets loaned to EU sub. EU sub writes off the loan interest to Barbados sub, TT largely exempts income tax on it and only pays 2.5% in Barbados, pays as dividends to Can sub. Tries to claim it as exempt surplus (deductible s.113(1)(a)). Not FAPI because loan is incidental to active business of the corporate group (s.95(2)(a)(ii)).  CRA reassesses on basis of 95(6) 🡪 only acquired shares in Barbados sub to reduce tax. Ignores the share purchase, treats it as though Can sub loaned directly to EU sub. TP appeals.  Issue: was the acquisition of shares in Barbadasco principally an avoidance transaction prevented by 95(6) or the GAAR? |
| Held: for TP |
| “would otherwise be payable” = “tax benefit” |
| * + Univar does not reduce, avoid or defer any tax |
| * + MNR argues that the benefit is only seen in comparison to the alternative (*Canada Trustco Mortgage* SCC) |
| * + - Argues that in reality it was Can sub loaning money to EU sub. Barbados was just a conduit |
| * + Court: MNR cannot re-characterize what happened- the only alternate that should be considered is the possibility of the alleged avoidance transaction not having occurred |
| * + - Had TP not acquired shares of B, there would be no tax otherwise payable to avoid/deter/ or reduce     - To do anything else would be to be operating on a hypothetical situation: that Can had lent directly to EU. Can’t do this. |
| * + For the GAAR- no tax benefit as no reduction, avoidance or deferral of taxes     - Same reasoning as above. Cites IT bulletin, saying you can’t recharacterize an Xact when determining whether it is an avoidance Xact. Have to work on what happened in reality. |
| Avoidance transaction |
| * + Principal purpose/ primarily for bona fide purposes (factual finding) |
| * + - Not necessary because no tax benefit, but based on facts wouldn’t have found principal purpose/ primary purpose to be avoidance |
| MNR dwells on how the TP could have structured- court shoots down the hypothetical . |



# CHAPTER 9: Anti- Deferral Rules

## Foreign Accrual Property Income (FAPI)

Purpose: - avoid double tax on corps – concern on significant investment, not small SH

Process: Is it FAPI?

1. Is it a FA?
   1. Add up DE% 🡪 is it >1%?
   2. Add DE% and IE% to get AE%--> is it >10%?

🡺 yes to both? Then FA

1. Is it a CFA?
   1. Add up persons in s. 95(1) def’n

🡺 if votes > 50%, then de jure control 🡪 CFA

1. Is it FAPI or non-FAPI?
   1. Check the chart (below). If property income, not exempt, not deemed incident to ABI, then FAPI

**Direct vs. Portfolio Investments:** direct has 10% votes and value

#### s.95(1): FA / CFA def’n

**“Foreign Affiliate”:**

nonres corp of a TP res in Canada, in which:

1. direct equity % > 1% (of shares of any class, not aggregate), AND
2. aggregate of equity % TP + related persons ≥ 10% (if intermediary use proportion – greater than 100% no problem, what matters is >10%)
   * exception: non-resident owned investment corporations don’t have FA’s

**“Controlled Foreign Affiliate”:**

a FA that is controlled by:

1. the TP;
2. the TP and <= 4 other Canadian residents (regardless of relationships with each other!!);
3. someone NAL\* with the TP; OR
4. the TP and someone NAL\* with TP

\*s.251(1) deems related persons to deal at NAL. Whether un-related persons are NAL is a question of fact

**Equity Percentage:**

Aggregate Equity Percentage ; Direct Equity Percentage ; Indirect Equity Percentage

AE% = Σ (DE% + IE%)

IE% = DE% in intermediary1 x … x DE% of intermediaryn in FA

If AE% >= 10% 🡪 FA

\*\* note: AE% can be larger than 100%. All that matters is whether it is > or < to 10%.

#### s.251(2): Related Persons:

**(b):** corp related to:

(i) controlling person,

(ii) members of controlling group,

(iii) person related to (i) or (ii)

**(c):** two corps related if:

(i) controlled by same person,

(ii) two related persons control two different corps

**“Control” = Legal Control (de jure):** > 50% of votes\*\*. Can be direct or indirect (ie. AE%)

\* calculation for FAPI occurs at year end, so what matters is that the corp is controlled at year end (if not, no FAPI)

\*\* add up persons in s.95(1) definition: if > 50% then control

#### s.113(1)(a)(b)(c)(d)

#### Reg 5901:

**(a):** is lesser of [dividend] or [exempt surplus less taxable deficit]

**(b):** is lesser of [dividend less (a)] or [taxable surplus less exempt deficit

##### Definitions:

#### Reg 5907(1): def’ns

**Exempt Surplus:** (A-B)

\*\*note: if exempt surplus is negative, it is an exempt DEFECIT.

A = [ (ii): exempt earnings + (iii): portion of dividend from exempt surplus of any FAs of FA + (iv)+(v) ]

* + (ii) Exempt Earnings:
    - (d) “net earnings” from ABI (ie. after tax)
    - (a) CG: exempt portion of CG and the CG excluded from FAPI (ie those connected with ABI)B = (ii: exempt loss + iii: income tax on inter-affiliate dividend(w/hold) + iv: portion dividend paid out of exempt surplus
  + (iii): exempt surpluses flow all the way up
    - so if a FA has its own FA, any exempt surpluses that sub FA pays to the parent FA are exempt when paid to the TP as well
    - \*\*\* NOTE: this means that **EVEN FAs FROM NON-DTC CAN HAVE EXEMPT SURPLUS!!**
      * Even though its own surpluses are not exempt, any portion of those surpluses flowing up from a DTC FA **would** be exempt surplus.
  + (iv): ??
  + (v): Canadian affiliates of FA
    - any dividends that WOULD be deductible under s.112 if received directly also exempt
      * (ie. if FA has a CanSub., any dividends paid by it to FA would fall under s.112 if it had gon straight CanSub to TP)

B =

(ii): Exempt Loss: (A+C)

* + A = (a): allowable capital losses in FAPI (not excluded losses)
    - ??? ~~capital loss – FAPI – tax refunded – tax refunded for loss~~
  + C = (d): net loss from AB COB in Canada or designated treaty country

(iii): taxes paid on A(iii)/(v): taxes paid on dividends from other FA’s

(iv): dividends previously paid out of exempt surplus

Taxable Surplus:(A-B)

A = (i: taxable earnings + iii: portion of dividend from another FA from taxable surplus)

* < if nontreaty country (ii) ABI + income POD AB assets) >
  + (ii) taxable earnings:
    - (a): net earnings (after tax) from ABI earned in a country – exempt earnings
    - (b): net earnings in respect of FAPI
    - (d) TCG from dispositions of excluded property (from FAPI) NOT in Canada or a DTC
  + (iii) portion of inter-affiliate dividends paid out of taxable surplus

B = (ii: taxable loss + iii: income or profits tax on inter-affiliate dividends + iv: portion dividend not of taxable surplus)

* + (i):
    - (a) taxable loss: net loss from ABI in a country, but not exempt loss
    - (b) net loss from FAPI
    - (c) allowable capital loss from dispositions of capital property NOT in Canada or a DTC
  + (ii) tax on inter-affiliate dividends from taxable surplus
  + (iii) dividends previously paid from taxable surplus

##### FAPI:

1. goes into taxable surplus of exempt surplus of FA for s.113(1)(b)+(c)
2. Accrual tax for Cdn resident SH controlling FA (alone, or pool 5 Cdns)

##### Calculating FAPI:

**s.95(1): FAPI** = (A+B) – (D+E)

A = (table income)

B = (table gains) - accrued since 1975, dispositions of property other than excluded

D = (table loss) - loss from prop, loss from bus other than active, loss from non-qualifying

E = (table allowable capital loss)

|  |  |
| --- | --- |
| **FAPI:** Taxable Surplus | **Non-FAPI:** Exempt Surplus |
| Income from:   1. property (rent, royalties, dividends, interest) 2. AINT \* 3. investment business \* 4. nonqualifying biz \*\* 5. biz income deemed from property 6. non-active business (ie. deemed)\*\*\* 7. net TCG from disposition of non-excluded property 8. income from CFA in respect of “offshore investment fund property”   \* unless in s. 95(2)(a)  \*\* “nonqualifying” is a stick used to get other countries to sign TIEA  \*\*\* deemed by s. 95(2)(a.1),(a.2),(b) as in-active business | Income from:   1. active business \* 2. incident/pertaining to active business 3. property income deemed from active biz  * 95(2)(a)🡪 generally payments from non-res company TP has QI in.  1. net TCG from dispositions of excluded property 2. dividends from FAs / would be deductible under s.112   \* ie not an investment business, or something deemed not active business by s.95(2)(b). Refer to caselaw on s. 125 meaning of “active business” wrt a CCPC |

##### Included in FAPI:

|  |  |  |
| --- | --- | --- |
| ITEM | RELEVANT PROVION | EXPLANATION |
| “ Typical Income from property” | 95(1) | Interest, rent, royalties and dividends |
| AINT income | 95(1) | Income arising from trading activities |
| Trading or dealing in indebtedness | 95(1) |  |
| Investment Business | 95(1) | Business carried on principally to earn income from property (interest, dividends, rents, royalties, or any similar returns or substitutes for them), income from insuring or reinsuring riskd, income from factoring trade accounts recievable and profits from the disposition of investment property (itself a defined term)  Exceptions (ie ARE active) IF  1) conducted primarily with AL persons  2) Certain kind of business: regulated financial business, real estate developing business, money lending business, business of leasing or licensing, or insurance business)  3) more than 5 full time employees |
| Business Income Deemed to be from a Business other than an active business | 95(2)(a.1)  95(2)(a.2)  95(2)(a.3)  95(2)(b) | Certain Canadian Source Sales income  - applies to sales of property and certain related services that affect the computation of income by Canadian residents not dealing at arms length with a foreign affiliate ( if you put a sub in a low tax jurisdiction and to buy things from a supplier- keep the profits there)  -Transfer pricing rules could also work, but these rules apply even if the prices would work for TP  Income from Insuring Canadian Risks  applies when income arising from insuring Canadian risks is deflected into a foreign sub  Canadian source financial and licensing income  Applies where financing charges and trading profits from dealing in indebtedness and payments in connection with “lease obligations” are made by persons resident in Canada  Exception: if derived from foreign sources  Services Deemed Separate  2 situations  1) service fees are deductible in in computing the Canadian business income of a person for whom the affiliate is a controlled foreign affiliate for by any related person (ie payments of service fees by member of a related group that are deductible in computing Canadian business income will be treated as FAPI)  2) where service fees are paid by Canadian resident individuals to their foreign affiliate |
| Business Income Deemed to be from a Property | 95(2)(l) | Income from business other than an investment business, whose purpose is to derive income from trading or dealing in indebtedness (ir trading or dealing in indebtedness with NAL person- that income deemed)  Exception: Arms length in the country where the business is carried on, affiliate business, regulated banks |
| Non Qualifying Business | 95(1) | This is specifically excluded from “active business”  Income from a business carried on by a FA through a PE in a “non qualifying country” – which means a country that CAN doesn’t have a treaty or TIEA with |
| Net TCG from non excluded property | 95(1) | excluded property (so anything OTHER THAN THESE)  1) property used to produce business income  2) property not used in an active business, if it is considered to be a transmission of business income from one non-resident corp to another (interest, rent, royalties that are decutable)  3) shares of a corp that is carrying on an active business |
| An amount included in respect of an offshore investment fund |  |  |

#### s.95(1): Income from Property:

income from property (passive, rent, royalty, dividends), includes: FA income from investment biz + ANIT

- excludes: a) income from biz deemed not active, b) income pertaining/incident to active, c) income from non qualifying

#### s.95(2)(L): Deemed Income From Property:

income from biz other than invest biz, purpose to derive income from trading/dealing in indebtness, except: AL in country where biz carried on, affiliate biz AR, regulated banks etc.

#### s.95(2)(a.1): Deemed from Biz other than active:

income from sale of property is > 10% NAL (less than 90% is AL) – doesn’t apply if primarily COB in FA country

#### s.95(2)(b): Services deemed separate, not active:

for (i) payment for services deductible in computing income Cdn resident in respect of which FA is FA , or (ii): services performed by Cdn resident in respect of where FA is FA

#### s.95(1): Investment Business:

COB by FA in yr, purpose earn income from interest, rent, dividends, royalties, similar), insurance risk, buy/sell AR, disposing investment property, Except: (these ARE active) regulated (banks, trust companies, credit unions), unregulated (insuring, loaning) w/ 5+ employees

|  |
| --- |
| ***Canada TrustCo*:** |
| Canada PE, Netherlands FA – Neth: interest from non res sources not taxable – Can gives note to Netherlands, earn income on that + Cdn property (investment biz become FAPI) |

##### Excluded from FAPI:

|  |  |  |
| --- | --- | --- |
| ITEM | RELEVANT PROVISION | EXPLANATION |
| Income from an active business | 95(1) | Excludes: investment business, businesses deemed under 95(2), AINT, non qualifying business |
| Income that pertains to or is incident to an active business | 95(1) | So if it pertains to things that are an active business |
| Income from Property that is deemed to be income from an active business | 95(2)(a) | Generally payments from related non-resident corporations that carry on an active business |
| Net taxable capital gains from dispositions of excluded property | 95(1) | excluded property  1) property used to produce business income  2) property not used in an active business, if it is considered to be a transmission of business income from one non-resident corp to another (interest, rent, royalties that are decutable)  3) shares of a corp that is carrying on an active business |
| Dividends received from another foreign affiliate of the TP and dividends that would be deductible under 112 (if received by a corp resident in Can) | 95(1) | ITA 112 – deduction of taxable dividends from corps resident in can  allows deduction in the computation of income of all such dividends received from taxable can corps , controlled corps resident in Canada and in some circumstances, non resident corps carrying on business in Canada (ie- inter corporate dividends) |

#### s.95(1): Active Business:

income from any business, includes “incidental/pertaining,” does not include (a): investment business, (b): s.95(2) deemed not active, (c) non qualifying <FA w/ PE in non treaty>

#### s.95(2)(a): Deemed ABI:

recharacterizes certain property income as active business income (ABI)

* + - (i) DIRECTLY RELATED INCOME
      * deems passive income active (CanCo has two FA’s, both qualifying. One w/ active income transfers money to the other 🡪 DEEMS that to be ABI with second FA (ie. one rents property to the other, rental payments are ABI))
      * This is how Univar payments to Barbasco became not FAPI
    - (ii) INTER-AFFILIATE PAYMENTS
      * inter-affiliate payments deductible in computing TP’s ABI (paid or payable; directly or indirectly)
    - (iii) factoring of trade account receivable
      * to the extent that they’re derived from active business of another FA
    - (iv) INCOME LOANS OR LENDING ASSETS
  + ONLY to the extent that it is from a source outside of Canada
  + Must have a “**qualifying interest**” (QI)
    - S.95(2)(m) defines as: 🡪 >10% of votes AND value (including indirect)
      * (i) >= 10% of outstanding voting shares
      * (ii) >= 10% of FMV of outstanding shares
      * (iii)/(iv) indirect ownership rules
  + must be **controlled ALL YEAR**
    - s.95(2)(a) does not apply to year interest/shares are acquired
    - s.95(2.2)(a) solves this
      * deeming rule that prevents s. 95(2) recharacterization from not applying to FA’s sold/bought/whatever within the year.

|  |
| --- |
| Marsh and McLennan v. R [1983] FCA |
| To be “incidental to ABI,” investment assets must be EMPLOYED or RISKED in the day-to-day business |

|  |
| --- |
| Ensite v. r [1986] SCC |
| Must be a link between the definite obligations of a business and the investment assets |

#### s.95(1): Capital Gains from Excluded Property:

property for purpose income producing ***Ensite*:** capital is employed/risked in the business

##### Process:

1. Is it a controlled FA?
2. S.91(1): Attribution of Income: Participating %
3. S.91(4): Credit/Deduction for FAPI
4. S.91(5): Deduction for dividend out of previously taxed FAPI
5. S.92(1): ACB adjustment
6. **Controlled Foreign Affiliate:**
7. TP has legal/dejure control of FA (s.256(6.1) control notwithstanding others also control)
8. Deemed control – FA would be controlled if legal control by total of: resident SH, all NAL SH, and any 5 Cdns + NAL

**Corporations:**

**Controlled Foreign Affiliate:**

#### s.95(1):

* **(a):** FA of TP that is controlled by TP,
* **(b):** TP would control if
  + (i) controlled all TP shares,
  + (ii) all shares held by NALP,
  + (iii) all shares held by any 4 residents of Canada (regardless of relationships between them)
  + (iv) anybody NAL with those 4 Canadians.

##### Participating Percentage:

#### s.91(1):

TP includes in income, FAPI for each share on their participating percentage, determined at end of each year, calculated by:

#### s.95(1):

“participating %” of particular share:

* + **(a):** $5000 exemption (minimum, ie. doesn’t apply to SH w/ less than $5000),
  + **(b):** if above 5000, (i): equity % (direct + indirect) on assumption only 1 share held

ie. 50% direct equity percentage:

50 c/s = 1% participating % per share – responsible for 50% of FAPI

w/ indirect:

70/50 = 1.4% x 50 – 70% of FAPI

#### **s.91(4):** tax credit for FAPI:

indirect credit for foreign accrual tax (FAT) paid in respect of FAPI.

Credit = (FAT attributable to income not already deducted) x (relevant tax factor) x (excess of amount included in income under s.91(1) over amounts deductible under s.91(4))\*

* + \* both for the 5 preceeding years

**1/T** = relevant tax factor << use this to calculate deduction

T = .38? (theoretical Canada rate) 🡪 1/T = 2.6316

<FAPI \* foreign tax rate \* 1/.38>

#### **s.92(1):** adjustment to cost base of shares:

**(a):** additions: add s.91(1) inclusion

**(b):** deduction: s.91(4) deduction

#### s.91(5):

deduction for dividends paid by CFA, paid out of previously taxed FAPI, engages rules of s.113(1)(b)(c)

* where TP receives dividend from CFA, out of taxable surplus, can deduct lesser of:
* (a) amount by which dividend exceeds s.113(1)(b) deduction; or
* (b) net addition to ACB in respect of the share (s.91(1) inclusion minus s.91(4) deduction)

##### Anti Avoidance Rules:

#### s.95(6)(a):

if tax motivation is primary reason for acquiring/disposition shares – then deemed not to have happened

**Interpretation:**

**s.3 Interp Act:** interpretation is ambulatory, reverses *Melford Developments*

**Art 3 OECD:**

**(1):** specific definitions: enterprise, person

**(2):** if undefined (depends on domestic law), use definition at time of dispute

***Crown Forest*:**SCC approves using commentaries