LAW 603 – International Taxation

Mark Woltersdorf

Winter 2019

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Case Law Tests

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I: Basic Principles of International Taxation



A: International Taxation and Domestic Taxation

Introduction to International Taxation

What Allows a Country to Tax?

* There must be some sort of **connecting factor** for a nation to tax something.
* The connecting factors in international tax include:
  + Citizenship.
  + Residency.
  + Activity (Where, how, and what activity all being important considerations).
* As a general rule, countries reserve the right to tax income at a source – something which is generated in the country.
* Theory is that active income is taxed at the same rate regardless of whether one is a resident or non-resident, while inactive or passive income is taxed at a lower rate and subject to full tax rates in the foreign jurisdiction.
* Certain countries have the right to tax passive income which is earned in certain circumstances.
  + Canadian tax rates on interest income can be subject to up to 48%.
    - E.g. A deposits all their money in the Bahamas, which has a tax rate of 5%.
      * Canada reserves the right to tax the individual on that income in the Bahamas.
    - E.g. A incorporates in the Bahamas and transfers their money to the company via an interest-free loan.
      * Canada and the US retain rights to tax passive income in certain circumstances.
        + Canada uses the **foreign accrual property income** regime, which requires one to include as income 4x the taxes paid in the foreign jurisdiction (further *infra*).

Basic Structure of the ITA

* Division B provides for the five sources of income:
  + Employment.
  + Business.
  + Capital.
  + Property.
  + Other.
  + If something does not fall under one of these five sources of income, then it cannot be taxed.
* Accumulation of all Division B income produces net income.
* Net income, minus deductions, produces taxable income.
  + Division C produces taxable income for a resident.
  + Division D produces taxable income for a non-resident.
  + Both Divisions C & D provide for non-source specific deductions.
* From taxable income, one computes tax payable.
* Items that are included in income, deductible from income, and exempt (neither deductible or includable).
* Can be modelled as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | Included? | Deductible | Exempt |
| Employment |  |  |  |
| Business |  |  |  |
| Capital |  |  |  |
| Property |  |  |  |
| Other |  |  |  |
| Net Income |  |  |  |

* These principles apply in any tax situation, including for international tax.
* Many deductions and credits the ITA are means-tested.
* The ITA is set up as it is with net income and taxable income for certain reasons.
  + Net income less deductions produces taxable income.
    - Certain amounts must be included in net income and then are not taxable due to a full deduction, such as worker’s compensation (these amounts may prevent other means-tested deductions from applying).

B: The Purpose and Interpretation of Tax Treaties

Canada’s Networks of Tax Treaties

Sources of Tax Law

* Always start with domestic laws, and never with a treaty, due to how the latter is paramount to the former.
  + After determining what the domestic law says, examine the treaty between the source country and see whether it modifies the taxation of that item, as in theory, treaties override domestic law.
    - Practically, certain jurisdictions (e.g. certain US states) may not be bound by the treaty.
    - Furthermore, in the US, any legislation enacted after the treaty is not subject to the treaty.
    - The last protocol of the US-Canada tax treaty was in 2007.
* Tax treaties are meant to govern the taxation of an item without exception, in theory.

Purpose of Tax Treaties

* Four main purposes of a tax treaty:
  + Elimination and/or reduction of double taxation (original purpose).
  + Exchange of information.
  + Allocation and limitation of taxing powers between two sovereign nations.
  + Assist with collection of tax income.
    - E.g. Canada and the US, in theory, will collect taxes for the other, but in practice collection only occurs with large debts (amounts measured in millions).

Core Concepts in International Tax

* “Carrying on business” (“**COB**”) is a relevant term in international tax.
  + Section 248 of the ITA defines “business” as a profession, calling, manufacture, or undertaking of any kind, and with certain exceptions an adventure or concern in the nature of trade, but not an office or employment.
    - Essentially any non-employment activity carried on will be a business.
* Most tax treaties introduce the idea of a **permanent establishment**
  + E.g. Someone COB in the US is not sufficient to be prone to US tax, unless there is a permanent establishment.
  + Generally, a permanent establishment is a fixed place of business.
  + Permanent establishments are relevant for active income, while passive income is more concerned with source.

Model Tax Treaties

* Both the OECD and UN have created model treaties, with most developed countries adopting the former and most developing countries the latter.
* The OECD model does not discriminate in active taxation, and offers less treatment against passive treatment.
* The UN model allows for a larger share of tax revenue to be retained in the source country.
* The Canada-US treaty is a combination of the OECD and UN models.

Principles of Tax Treaty Interpretation

Interpretation of Treaties

* Article 31 of the Vienna Convention on the Law of Treaties sets out interpretation of treaties.
  + Treaties should be interpreted in their plain and ordinary meaning in light of their context and purpose.
    - Context includes any agreement made in connection to the treaty, any instrument made for the same and accepted by the other party, and so on.

**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 connexion with the conclusion of the treaty;

(b) Any instrument which was made by one or more parties in connexion 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. SUPPLEMENTARY MEANS OF INTERPRETATION**

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.

***Melford Developments Inc v The Queen*** ([SCC 1982](https://nextcanada.westlaw.com/Document/I10b717d015cf63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Static Interpretation Applies to Tax Treaties

* Facts:
  + Referenced a term which had been amended out of the ITA.
    - Taxpayer argued that the amendment since the tax treaty was passed defined the issue.
  + Withholding taxes applicable on interest, subject to treaty relief.
    - Amendment included guarantee fees as interest.
      * Taxpayer claimed their income was not interest due to the application of the tax treaty, which took the older definition of “interest”.
* Holdings:
  + SCC applied a **static interpretation** and required use of the definition in place when the tax treaty was signed.

Laws enacted by Canada to redefine taxation procedures and mechanisms with reference to income not subjected to taxation by the Agreement are not, in my view, incorporated in the expression "laws in force" in Canada as employed by the Agreement

* Overturning Melford, Parliament amended the *Income Tax Conventions Interpretation Act* such that if the ITA changes, it will be the new definition that follows when a tax treaty applies – a **dynamic/ambulatory interpretation**.

***The Queen v Crown Forest Industries Ltd*** ([TCC 1992](https://nextcanada.westlaw.com/Document/I10b717ccea1f63f0e0440003ba0d6c6d/View/FullText.html?docFamilyGuid=I503095f0723a11d7947cc0bc28d0837a&transitionType=History&contextData=%28sc.Default%29); [FCA 1993](https://nextcanada.westlaw.com/Document/I10b717ce59d763f0e0440003ba0d6c6d/View/FullText.html?docFamilyGuid=I5171de6072d011d7947cc0bc28d0837a&transitionType=History&contextData=%28sc.Default%29); [SCC 1995](https://nextcanada.westlaw.com/Document/I10b717d04f4263f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Close Reading of Tax Treaties (See infra for Residency; Treaty Shopping)

* Facts:
  + Fletcher is parent corporation based in New Zealand, and is the parent and sole owner of two corporations:
    - Norsk has its mind and management in the Bahamas and a permanent establishment and carries on business in the US as a shipping company.
    - Crown Forest Industries has its mind and management in Canada.
  + Under US domestic law, Norsk is exempt from paying tax on worldwide income due to being a worldwide shipping company, but are still taxed on their US source income.
  + Norsk rents boats to Crown Forest, for which Crown Forest makes payments to Norsk, who is a non-resident.
    - A withholding tax is applicable for this, with the applicable rate dependant on whether the other corporation is resident or not resident of the United States.
    - Article IV(1) notes that one is a resident if it is paying tax by reason of its domicile, residence, citizenship, place of management, place of incorporation, or any other criteria.
      * Norsk interprets this as stating Norsk is a US resident.
* Holdings:
  + Norsk is not a US resident corporation, and does not need to pay income on its worldwide income; it only needs to pay tax on its US source income.
    - Paying tax on US source income is not paying tax because the party is located in the US, by domicile or residence, or any of the treaty’s other grounds.
  + Because the basis of tax is source, and the income is taxed due to it being sourced in the US, then Article IV(1) does not apply to deem Norsk as US resident, and Crown Forest should have withheld 25%.
  + When interpreting a treaty, interpret the meaning and not simply the words.

***Edwards v The Queen*** ([FCA 2004](https://nextcanada.westlaw.com/Document/I10b717d4d27663f0e0440003ba0d6c6d/View/FullText.html?navigationPath=Search%2Fv3%2Fsearch%2Fresults%2Fnavigation%2Fi0ad7140b00000168c1ce2bd36977d97c%3FNav%3DMULTIPLECITATIONS%26fragmentIdentifier%3DI10b717d4d27663f0e0440003ba0d6c6d%26startIndex%3D1%26contextData%3D%2528sc.Search%2529%26transitionType%3DUniqueDocItem&listSource=Search&listPageSource=aa6f27ee9fb5ce76117d2260c872518a&list=MULTIPLECITATIONS&rank=0&sessionScopeId=14cab120e1dd6223754e9e1360556e7a8cd2d9a600d08deb0ebf472ae5c38300&originationContext=NonUniqueFindSelected&transitionType=UniqueDocItem&contextData=%28sc.Search%29)) – Taxpayers Expected to Know Income Tax Minutia

* Facts:
  + Taxpayer, a Canadian resident, worked for a subsidiary of a corporation resident in Canada.
  + Canada-China Tax Treaty notes that airline employment income is taxable only in China.
    - Article III(1)(b) defines territory of China as all territory in which Chinese law applies.
  + Based on Article III(1)(b), the Court had to consider whether Hong Kong (at the time returned from the lease) is part of China, and thus captured by the exemption rule in the treaty.
    - Taxpayer excluded income from the taxation year prior to Hong Kong being returned to China.
* Holdings:
  + Recall Melford– use the meaning of domestic legislation at the time a treaty is entered into.
    - When a term is undefined, use the meaning contained in the ITA as amended from time to time.
  + Diplomatic agreements suggested that Chinese tax law would not apply to Hong Kong, following repatriation.
    - Hong Kong would retain its own tax system.
    - Due to these notes, no treaty between Canada and Hong Kong (through China) existed.
  + Taxpayers are expected to be knowledgeable about every provision in the ITA, and bear the onus of that knowledge, even for income tax minutia:

I reject this argument without hesitation. First of all, I do not accept that the construction advocated by the parties goes against the natural meaning of the Tax Agreement. As indicated, the definition of the PRC in terms of where "Chinese Tax" apply, lends itself to the common view expressed by the parties. Second, the evidence reveals that the Canadian government has consistently maintained that the Treaty does not apply to Hong Kong or to the HKSAR and this position has been known in tax circles and accessible to anyone interested since at least 1997. To the extent that the appellant claims to have been surprised by the Canadian position, it can only be because he did not see fit to inform himself.

***Prevost Car Inc v The Queen*** ([FCA 2009](https://nextcanada.westlaw.com/Document/I64ed2a25e4d066bce0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Resolving Interpretative Difficulties via Factual Examination

* Facts:
  + Prevost Car Inc (PCI) is wholly owned by a Netherlands entity (PHBV).
    - 5% withholding tax on dividends paid from PCI to the Netherlands entity.
      * Imposed by the Canada-Netherlands tax treaty, suggesting an OECD style treaty.
  + Netherlands entity is controlled by two other entities:
    - British corporation has a 49% interest (Henly’s); Swedish corporation has a 51% interest (Volvo).
  + Volvo and Henly’s sign a shareholder agreement, requiring that 80% of the earnings of PHBV be paid as dividends to shareholders.
    - Beneficial owner of PCI (PHBV) is a resident of the Netherlands.
  + CRA took the position that PHBV is a conduit company – its only aim was to flow funds through it.
    - Applied the pro-rata shares of PHBV’s owners to the dividends issued from PCI.
      * Applied the dividend rates applicable for the Swedish corporation and British corporation.
* Holdings:
  + Issue at TCC was to determine how to define “beneficial owner” under the tax treaties.

It seems to me that the plain ordinary meaning of the expression "beneficial owner" is the real or true owner of the property. The property may be registered in another name or held in trust for the real owner, but the "beneficial owner" is the one who can ultimately exercise the rights of ownership in the property.

* + The beneficial owner is the party entitled to enjoy the income.
    - PHBV is not a party to the shareholder agreement, and there was not under that agreement an automatic flow of funds – PHBV was therefore not required to declare flow-through dividends.
  + In order for PHBV to be the trustee and not the beneficial owner, the shareholder agreement needed to have explicitly required PHBV to pay out dividends and hold profits on trust for that purpose.
    - Shareholder agreement only stated that the shareholders would agree to have 80% of the profits from PCI as dividend, but there was no requirement in the agreement for PHBV to funnel the funds through, in such a way that would establish that PHPV was only the legal owner and not the beneficial owner.

US Technical Explanations

* **Technical Explanations** (“TE”) supplement the US-Can Treaty, providing explanatory comments to the treaty.
  + A domestic document prepared after the fact by the US administration.
* Article 32 of the Vienna Convention does not assist, as the Technical Explanation is not preparatory.
* Various other articles may also be applicable, but Coblentz relies on Articles 31(2)(b) & 31(3)(b).
  + Article 31(2)(b) provides for instruments prepared in connection to the conclusion of the treaty.
  + Article 31(3)(b) allows for practice relating to interpretation.

While I am certain that the Technical Explanation does not fall within Article 32 of the Vienna Convention, it is arguable whether it falls within Article 31(2), or 31(3) (Colbentz).

***Coblentz v The Queen*** ([FCA 1996](https://nextcanada.westlaw.com/Document/I10b717d0f1bf63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – US Technical Explanations Are Usable for Treaty Interpretation

* Article 31(2) is more important than Article 31(3) of the Vienna Convention.
  + Article 31(2)’s wording is a principle of interpretation, while Article 31(3) only requires that the interpreter “take into account”.
* Due to the Vienna Convention, US Technical Explanations can be used to ‘facilitate our understanding” of tax treaties, and can be used as an interpretative aid (paras 15 – 16).

In the reasons that follow it will become evident that I am of the view that the Technical Explanation facilitates our understanding of Paragraph 1 of Article XVIII and does not contradict it. In reaching this conclusion I am mindful of Iacobucci J.'s instruction to have regard to the Convention's purposes when interpreting its provisions. In my view, those purposes are central in resolving the legal debate which has arisen in this case. This is an appropriate place to outline the Convention's purposes and, in particular, those surrounding Article XVIII.

* Technical Explanations may be used to assist in interpretation of the treaty.

… I am of the view that the Technical Explanation facilitates our understanding of Paragraph 1 of Article XVIII and does not contradict it. In reaching this conclusion I am mindful of Iacobucci J.'s instruction to have regard to the Convention's purposes when interpreting its provisions. In my view, those purposes are central in resolving the legal debate which has arisen in this case. This is an appropriate place to outline the Convention's purposes and, in particular, those surrounding Article XVIII.

***Kubicek Estate v The Queen*** ([FCA 1997](https://nextcanada.westlaw.com/Document/I10b717d1e9ca63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – US Technical Explanations Not Binding

* Held that Technical Explanation has the same status as an Interpretation Bulletin issued by the CRA.

The Technical Explanation is a domestic American document. True, it is stated to have the endorsation of the Canadian Minister of Finance, but in order to bind Canada it would have to amount to another convention, which it does not. From the Canadian viewpoint, it has about the same status as a Revenue Canada interpretation bulletin, of interest to a Court but not necessarily decisive of an issue.

* + Further, Technical Explanations are not binding on Canada, as they are domestic American documents.

***Allchin v The Queen*** ([FCA 2004](https://nextcanada.westlaw.com/Document/I10b717e19c7b63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – US Technical Explanations Not Binding, but Usable

* Essentially dismisses Kubicek by holding that Technical Explanations are “valid guidance”, albeit not binding.

While technical explanations attached to treaties are not binding on the Court, they may be accepted as valid guidance (see *Kubicek Estate v. R*. (1997), 97 D.T.C. 5454 (Fed. C.A.), at 5456).

* Perhaps the most valid statement, as the FCA in this case has reviewed the two previous cases.
  + However, none of the cases has full precedential value, so which approach is adopted will depend on the facts of a particular case.

Non-Discrimination Clauses

* Most OECD countries contain a non-discrimination provision, so as to prevent different tax treatment of capital importation whether one is a national or non-national; Article XXV of the US-Canada tax treaty is such a provision.

**Article XXV**

**Non-Discrimination**

1. Citizens of a Contracting State, who are residents of the other Contracting State, shall not be subjected in that other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which citizens of that other State in the same circumstances are or may be subjected.

2. Citizens of a Contracting State, who are not residents of the other Contracting State, shall not be subjected in that other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which citizens of any third State in the same circumstances (including State of residence) are or may be subjected.

***Renz v The Queen*** ([TCC 2002](https://nextcanada.westlaw.com/Document/I10b717d4182363f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Discrimination Construed Narrowly

* Facts:
  + Renz had US student loans, and moves to the University of Regina.
    - Claims a credit under s. 118.62 of the ITA for interest paid in respect of student loans; the definition of “interest” in that section specifically prescribes certain statutes which may be captured.
* Holdings:
  + The important element is where the taxpayer borrowed from.
  + Renz was not punished for being a US resident, but rather because he had not borrowed money under one the enumerated acts – the Act would deny a Canadian who does the same, and thus there was no discrimination.
    - Not discriminating due to nationality, but due to s. 118.62 requiring one to borrow in Canada.

In my opinion the words contained in section 118.62 of the Act apply equally to citizens of Canada and non-citizens of Canada.

***Saipem UK Limited v The Queen*** ([TCC 2011](https://nextcanada.westlaw.com/Document/I9a61a8e0963f25c0e0440021280d79ee/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Corporate Residency Determines Corporate Nationality

* Facts:
  + Saipem UK is incorporated in the UK; Saipem Energy is resident in the UK, and controlled by a Dutch affiliate.
  + Saipem UK, through a shareholder agreement, purchases the Dutch company’s interest in SEI, and then dissolves SEI, which results in all of its assets, shares, and tax attributes flowing into Saipem UK.
  + SEI carries on business in Canada through a permanent establishment in Canada.
    - Most treaties provide relief for business carried on in Canada unless the business is carried on through a permanent establishment.
    - SEI incurs losses: ITA only allows for loss carryovers to be claimed by a Canadian corporation.
      * Saipem UK acquires those losses following the dissolution of SEI.
  + Saipem UK deducts the business losses under s. 88(1.1), which is only permissible for Canadian corporations.
  + CRA denies the deduction; Saipem UK says that this is discriminatory.
    - Canadian corporation is defined under s. 89(1) as either a corporation incorporated in Canada or a corporation resident in Canada: CRA argues neither definition applies to Saipem UK.
* Holdings:
  + “Nationality” is not incorporation: to be a Canadian corporation, the corporation must be resident in Canada.
    - Both the OECD model treaty and the commentary support that interpretation.

Example of Interpretation – Differentiating Between “Social Benefits” and Income

Relevant ITA Provisions

* As defined in s. 248, “non-resident” means not resident in Canada.
  + Resident may be established through a comprehensive factual analysis establishing someone **resident** or **ordinarily resident** in Canada, or deemed to be resident under the ITA (sojourners, Canadian military).
* “Tax treaty” is also defined in s. 248 as a “comprehensive agreement or convention for the elimination of double taxation on income, between the Government of Canada and the government of the country, which has the force of law in Canada at that time”.
  + Incorporates only one of the four purposes of a tax treaty – the original purpose of eliminating double taxation.
* Section 250.1 provides for a non-resident person’s taxation year and income.

**Non-resident person’s taxation year and income**

**250.1** For greater certainty, unless the context requires otherwise

(a) a taxation year of a non-resident person shall be determined, except as otherwise permitted by the Minister, in the same manner as the taxation year of a person resident in Canada; and

(b) a person for whom income for a taxation year is determined in accordance with this Act includes a non-resident person.

* + Establishes that one is taxed at the same rate in Canada whether they are a resident or a non-resident.
* Section 81(1)(a) provides for statutory exemptions.

**Amounts not included in income**

**81 (1)** There shall not be included in computing the income of a taxpayer for a taxation year,

**Statutory exemptions**

**(a)** an amount that is declared to be exempt from income tax by any other enactment of Parliament, other than an amount received or receivable by an individual that is exempt by virtue of a provision contained in a tax convention or agreement with another country that has the force of law in Canada;

* + Part of Division B, which is for the computation of income.
  + E.g. US resident works in Canada and earns $5,000 of income. The US-Can Treaty exempts the first $10,000 of income earned in Canada for the US resident. Do they need to include that amount as income?
    - Yes; the plain wording of s. 81(1)(a) requires one to include that as income.
  + However, s. 110(1)(f)(i) then provides (for residents):

**Deductions [permitted] for payments**

**110(1)** For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted such of the following amounts as are applicable

…

(f) any social assistance payment made on the basis of a means, needs or income test and included because of clause 56(1)(a)(i)(A) or paragraph 56(1)(u) in computing the taxpayer’s income for the year or any amount that is

(i) an amount exempt from income tax in Canada because of a provision contained in a tax convention or agreement with another country that has the force of law in Canada,

* + - As a result, the $5,000 of employment income could be deducted, pursuant to the US-Can Treaty.
  + Lastly, s. 115(1) sets out a non-resident’s taxable income in Canada.

**Non-resident’s taxable income in Canada**

**115(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

…

(f) where all or substantially all of the non-resident person’s income for the year is included in computing the non-resident person’s taxable income earned in Canada for the year, such of the other deductions permitted for the purpose of computing taxable income as may reasonably be considered wholly applicable.

* + - Substantively the same deduction as that under s. 110(1)(f)(i), but for non-residents.
      * Division C would not apply to the non-resident, so an equivalent deduction is necessary in Division D.

***Swantje v The Queen*** ([TCC 1994](https://nextcanada.westlaw.com/Document/I10b717cc9cc763f0e0440003ba0d6c6d/View/FullText.html?docFamilyGuid=I16d33aa0747011d79c33f30f55d9158b&transitionType=History&contextData=%28sc.Default%29); [FCA 1994](https://nextcanada.westlaw.com/Document/I10b717cfe9e663f0e0440003ba0d6c6d/View/FullText.html?docFamilyGuid=I16e514f0747011d79c33f30f55d9158b&transitionType=History&contextData=%28sc.Default%29); [SCC 1996](https://nextcanada.westlaw.com/Document/I10b717ce805a63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Denial of OAS a Social Benefit Claw Back, Not a Tax

* Facts:
  + Swantje enjoys:
    - German pensions, which are exempt under the Canada-Germany tax treaty.
    - Old age security.
      * The OAS amount begins to be clawed back by Swantje’s pension income.
  + Section 180.2 applied to function as the OAS claw back, under which Swantje “shall pay a tax”.
  + Swantje decided to not include his pension fund, despite that needing to be included under Other as offset by the corresponding deduction under Division C.
    - Did this to prevent his OAS from being clawed back.
    - Claimed that despite the treaty establishing German pensions are not taxable, the claw back on OAS is essentially a tax and should be captured by the treaty’s tax relief.
* Holdings:
  + TCC agreed with Swantje; FCA reversed TCC’s judgment, and SCC affirmed the reversal:

We would add that in our opinion the provisions of the Canada-Germany Tax Agreement do not apply in these circumstances to prevent the operation of section 180.2 of the Income Tax Act.

* + SCC decided on the issue that this is not a tax, but a repayment of a social benefit not described in the ITA.
    - The *Old Age Security Act* defines the OAS benefit, not the ITA, and the treaty applies to tax payable.
    - Seems somewhat contrary to the plain wording of s. 180.2, which states that an individual “shall pay a tax under this Part” – i.e. under the ITA.
      * The tax being the claw back, which the SCC characterized as a repayment of a social benefit.
      * Plain wording should lead towards the Canada-Germany Tax Treaty applying.
    - Could be re-worded to “Any individual shall repay an amount” if the SCC’s desired outcome is sought.

***Peter v The Queen*** ([TCC 1996](https://nextcanada.westlaw.com/Document/I10b717cc9c5063f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – German Pension Reduction Indirect Tax and Not Social Benefit Claw Back

* Facts:
  + The CRA included Peter’s German pension income in the net income formula, leading Peter to appeal.
    - Age credit was eliminated, causing Peter’s taxable income to increase.
  + Treaty states the German pension is non-taxable.
* Holdings:
  + TCC differentiated Swantje because it was not a repayment, but rather because by removing the credit, the CRA has increased Peter’s tax payable and has thereby indirectly taxed Peter’s pension income.
    - Differentiation between repayment of OAS, and indirect tax on a German pension.

***John v The Queen*** ([TCC 1997](https://nextcanada.westlaw.com/Document/I10b717cc9fc063f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – German Pension Reduction Social Benefit Claw Back and Not Indirect Tax

* Facts:
  + John receives a foreign pension from Germany and France which is not tax payable.
    - Same situation – CRA uses net income rather than taxable income to compute John’s old age credit.
  + Reduction in old age credit due to the increase in net income from the foreign pensions.
* Holdings:
  + The age credit is a social benefit which is income-tested, and should be reduced with too much pension income.
    - Section 118(2) does not impose a tax, but instead reduces a social benefit – the age credit.

In my view, although the effect of the calculation might appear as though the foreign pension were being taxed, the Act does not impose tax by virtue of the provisions in subsection 118(2). It does no more than realize the reduction of a social benefit, i.e. the age tax credit, for those taxpayers "who, because of their higher incomes, have a lesser need of them".

* + Characterized the age benefit as a social benefit, and thus CRA’s actions did not produce indirect taxation, but a reduction of a social benefit – the opposite characterization to Peter.

C: Residency

Residency of Individuals

Relevant ITA Provisions

* Under s. 250(1), a person is a **deemed resident** if:
  + They sojourn in Canada for a period of 183 days or more;
    - To sojourn is to reside temporarily in Canada (i.e. not habitual abode).
  + They are a member of one of the enumerated classes (military, foreign service, etc.).
* Section 250(2) applies to elaborate on timing for when residency ceases.
* Section 250(3) captures persons “**ordinarily resident**” in Canada – not currently in Canada but usually resident there.
* Section 250(5) deems a person as non-resident in Canada if a tax treaty considers them as resident of another country.
  + Someone may be a resident of more than one country.
  + Article IV(2) of the US-Can Treaty acts as a tiebreaker rule for residency.

**Residence**

**IV(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 of the Contracting State in which he has a permanent home available to him; if he has a permanent home available to him in both States or in neither State, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests);

(b) if the Contracting State in which he has his centre of vital interests cannot be determined, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;

(c) if he has an habitual abode in both States or in neither State, he shall be deemed to be a resident of the Contracting State of which he is a citizen; and

(d) if he is a citizen of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

* + The CRA and the IRS function as competent authorities for Canada and the US, respectively.

***Thomson v Minister of National Revenue*** ([SCC 1946](https://nextcanada.westlaw.com/Document/I10b717cfef0d63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Differentiating Resident and Ordinarily Resident

* Facts:
  + Thomson, a Canadian, gives up his residence in Canada in 1923, and retires to the Bahamas.
  + He splits his time between the Bermuda, North Carolina, and Canada, spending the most time in the latter two.
    - The CRA alleged Thomson was a resident of Canada.
* Holdings:
  + For revenue purposes, one may be resident in more than one country.
  + The words “ordinarily resident” are broader than the word “residing”.

The context further indicates that the words "ordinarily resident" are broader than the word "residing," and that the former were used to cover a field that the latter did not occupy. The aim of Parliament was to tax, not only the residents of Canada, those who have here their permanent home, their settled abode, but also, those who live here most of the time, even if they are absent on temporary occasions. The first group comes under the classification of "residents," and the second under that of "ordinarily residents."

* + However, one must be assumed to be a resident somewhere.

For the purposes of income tax legislation, it must be assumed that every person has at all times a residence. It is not necessary to this that he should have a home or a particular place of abode or even a shelter. He may sleep in the open. It is important only to ascertain the spatial bounds within which he spends his life or to which his ordered or customary living is related. Ordinary residence can best be appreciated by considering its antithesis, occasional or casual or deviatory residence. The latter would seem clearly to be not only temporary in time and exceptional in circumstance, but also accompanied by a sense of transitoriness and of return.

* + A person may be resident in Canada without being ordinarily resident therein.
  + Ultimately held that Thomson is ordinarily resident in both North Carolina and Canada.

***Hauser v The Queen*** ([TCC 2005](https://nextcanada.westlaw.com/Document/I10b717ed666763f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Determining Residency via Comprehensive Factual Analysis; Counting Sojourning

* Facts:
  + Taxpayer intends to move to the Bahamas, but continues to be employed by Air Canada.
* Holdings:
  + Overall factual picture supports a finding of residency for Hauser:

Canada was a magnet that attracted the Hausers … Mr. Hauser's presence in Canada during the years in appeal was not occasional, casual, deviatory, intermittent or transitory. He was in Canada in great part because he had to be, to earn a living.

…

Mr. Hauser used the words "linger" or "lingering" to explain that his presence in Canada, most times during the years in appeal, was not voluntary but was required by his employment. The fact that one's employment compels the person to be in Canada does not lead to the conclusion that one does not reside in Canada. In fact, most often the opposite is true. Many multinational corporations send their nationals to live and work in Canada; they may or may not like it here, but they may reside here while working here. They are not lingering here while they are employed here. Similarly, just because Mr. Hauser believes he was not lingering in Canada most of the time he was in Canada during the years in appeal does not protect him from the possibility of residing in Canada.

[However,] Mr. Hauser never divorced himself from Canada. There were just too many attachments. He may have intended to sever coverage with OHIP, ship personal effects and household goods to Freeport but there were more important attachments to Canada that continued and were very significant: employment, a place to sleep, banking, for example. That he had a regular routine in Canada is confirmed by his willingness in 2000, notwithstanding Canadian winters, to take up management of a real estate project. (Hauser, at paras 58, 60, 61)

* + Residency or non-residency in another country is important only in two circumstances:
    - If there are tie-breaker rules in a tax treaty between the two countries in question; and
    - To the extent that a taxpayer must be resident in some country.
      * Non-residence in the other country can be relevant if only two countries are considered.
    - Relevancy may or may not be relevant if there is not a treaty.

Mr. Hauser's leaving Canada in 1997 is not dissimilar from a child leaving the family and moving into his or her own apartment, but on many evenings the child returns to the family home for dinner and on most weekends the child is at the family home "hanging around". It cannot be said in such circumstances that the child has given up his parents' residence.

I find Mr. Hauser was resident in Canada during taxation years 1997, 1998, 1999, 2000 and 2001. I therefore need not consider whether he is deemed to have been resident in Canada pursuant to paragraph 250(1)(a) of the Act in any of these years. (Hauser at paras 62–63)

* The judgment generally concerned the sojourner rule, rather than residency, despite the case being decided on the latter.
  + For the sojourning rule, do not count the day a taxpayer **arrives**, but do count the day a taxpayer **leaves**.

To be fair to both parties, I have not included the day, or part thereof, that Mr. Hauser entered Canada in any period; I have included the day Mr. Hauser exited Canada in any period … (Hauser, at para 44)

***Laurin v The Queen*** ([TCC 2007](https://nextcanada.westlaw.com/Link/Document/FullText?findType=Y&pubNum=6407&serNum=2010895116&originationContext=document&transitionType=DocumentItem&contextData=(sc.Default))) – Determining Residency via Comprehensive Factual Analysis; Counting Sojourning

* Facts:
  + Taxpayer attempts to cut most ties with Canada and never spends more than 100 days in Canada.
    - CRA assesses the taxpayer as “resident”, and not “ordinarily resident”.
* Holdings:
  + Laurin not resident.

The use of the word "includes" in subsection 250(3) seems to imply that there could be a third (undefined) category of Canadian resident who is neither deemed under subsection 250(1) to be a resident of Canada nor "ordinarily resident" within the meaning of subsection 250(3). It is not clear just what the characteristics of such a form of residency might be. No basis has been demonstrated in any event for concluding that the appellant falls within this narrow but undefined category. (Laurin at para 4)

* + For determining sojourner rules, date of arrival is not counted, but date of departure is counted.
  + Found that the taxpayer had put forth sufficient evidence to demolish the Minister’s assumptions on residency.

Putting the Crown's case at its strongest, it is that despite the demolition of the central assumptions upon which the assessments were based, he was still resident in Canada because of his visits here, his employment with a Canadian airline and his family and friends here … Once it is accepted that he did not sojourn in Canada 183 days in any year, he did not have a common law wife here, he did not have a home available to him here, what is left? We have the baldly stated assumption that he did not sever his residential ties with Canada … Moreover, to say that one has not severed residential ties with a country is not tantamount to saying that one is resident there. Residual friendships and employment connections do not create residency (or in this case a resumption of residency because it was not suggested that he was resident in Canada in 1993 to 1995). (Laurin at para 32)

* Difference between Hauser and Laurin is that the latter flew international flights rather than domestic flights.
  + Laurin spent significantly more time outside of Canada, and retained fewer necessary connections in Canada.
    - As Hauser quite clearly established, employment in a country alone may not be enough to establish residency (para 60).

***Filipek v R*** ([TCC 2008](https://nextcanada.westlaw.com/Document/I50770cc310a30d1ce0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Determining Residency via Comprehensive Factual Analysis; Importance of Taxpayer Credibility

* A case demonstrating how vital credibility is for determining issues of fact, which residency always centers upon.
* Facts:
  + Filipek, an Air Canada pilot, moved to Turks and Caicos, and broke most of his Canadian ties before moving.
    - Separated wife withdrew money from a “joint” banking account, and whether Mr. Filipek was aware of this was up to debate.
    - Filipek was on good terms with his parents-in-law, in the Vancouver area.
  + Unclear from the case whether he was living with his parents-in-law whenever he was based in Vancouver (190 days in a year) – Filipek testified he would camp out at Point Roberts during this 190 year period.
    - TCC found some issues with credibility of his testimony and this situation of residence as questionable.
* Holdings
  + Gold card from a Canadian bank and a loan from Canadian-resident in-laws were considered substantial financial ties to Canada, leaving several additional ties.
    - Filipek was only separated from his wife and not divorced; if the latter, it may have been likely that the relationships with the in-laws would have been less significant.
  + On the issue of the separated wife withdrawing funds from the joint account, the TCC did not accept Filipek’s (poor) explanation for that arrangement.
  + Likely would not have been an issue were it not for Filipek’s other ties and lack of credibility.

The overall picture I am left with is of a pilot whose work routine was centred out of Vancouver. Wherever else he might go — Turks and Caicos, or gambling in the Northwest United States, he always returned to the Vancouver area for work purposes. He maintains that his routine in the Vancouver area was to camp in Point Roberts, yet his bank records, his calendar and his association with his in-laws and common sense suggests this is not entirely accurate … (Filipek at para 31)

* + Lack of credibility of taxpayer’s testimony was fatal to his attempt to demolish assumptions:

That is not the case before me. Truth is a powerful concept: when you tell it, the future most often unfolds as you would like — when you don't, life can get messy. I do not believe all that Mr. Filipek told me. He outright admitted to misleading the Court on day one of his testimony, under the guise of not remembering … What this all does to Mr. Filipek is cast serious doubt on the truth of any of his testimony. Frankly, in attempting to paint a positive picture of having gone non-resident, he entangled himself in a web of exaggerations, falsehoods and deception. This is regrettable. Had he simply told the truth, the truth may, I will not say definitely it would have, but it may have supported a finding of non-residence. But now Mr. Filipek has made it difficult, indeed impossible for me to discern the truth. (Filipek at para 32)

* + Compare to Laurin where three mistakes in taxpayer testimony was not sufficient to destroy credibility:

I do not regard these alleged discrepancies in the appellant's evidence as justifying rejection of his entire testimony. His testimony was supported by the credible testimony of the other witnesses. It is the responsibility of a trial judge to make findings of fact on the basis of all of the evidence and not fasten on a few contradictions as a justification for rejecting an appellant's case outright. In this case it would require rejecting all of the evidence which destroyed the central assumptions on which the assessments were based. (Laurin*, supra*, at para 34)

***Elliott v R*** ([TCC 2013](https://nextcanada.westlaw.com/Document/Id6b7f40d30646fcfe0440021280d79ee/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Analytical Matrix for Determining Residency

* Facts:
  + Dealt with three individuals who worked in America as professional consultants for some time.
    - Come to Edmonton to provide consulting services for Syncrude.
    - On the facts, came to Canada with nothing but suitcases and left basically all their assets in America.
      * Keep US driving licenses with the American Auto Association, US cell phones, US life and medical insurance, maintained their bank and financial accounts in the US, returned to the US every month, and their families stayed in the US but visited Edmonton rarely.
  + Several options for the government in this case:
    - Factually resident in Canada.
    - Deemed resident in Canada due to being a sojourner.
    - Ordinarily resident in Canada.
      * The definition for resident includes ordinarily resident – persons who are not actually resident but ordinarily are.
* Holdings:
  + On the tie-breaker rules, almost certainly fall into the US.
  + Case demonstrates how the residency analysis for Article IV of the Can-US Tax Treaty is applied.
    - The TCC established the following matrix for examining residency and its interaction with tax treaties:

**III. The Analytical Matrix or Grid to Determine the Appellants' Residence**

A. The first issue to be decided is whether the Appellants were resident in Canada for purposes of the ITA. This question potentially has two components:

(i) were they factually resident here as that term has been interpreted for purposes of the ITA; and

(ii) if they were not factually resident in Canada, are they deemed to have been resident in Canada under paragraph 250(1)(a) of the ITA applicable to those who sojourn in Canada for 183 days or more in a given year.

B. If the Appellants were not resident in Canada in the years in question, the entire analysis ends there and the Appellants are successful.

C. If the Appellants are found to have been resident in Canada for purposes of the ITA, the analysis must then turn to the Treaty and in particular to Article IV. A finding that they are taxable under the ITA based upon their being resident or being deemed to be resident in Canada will make them residents of Canada for purposes of the Treaty by virtue of paragraph 1 of Article IV. However, Article IV continues with its so called "tie-breaker rules" if a person is a resident of both treaty countries. It is conceded in this case that the Appellants are each residents of the US for purposes of paragraph 1 of Article IV of the Treaty. Therefore, the application of the tie-breaker rules in paragraph 2 of Article IV of the Treaty will need to be considered and applied.

(i) The hierarchy of the paragraph 2 tie-breaker rules begins by deeming a dual resident to be a resident of the country in which he had a "permanent home available to him". It is conceded that each Appellant had a permanent home available to him in the US. The first issue to be decided under the Treaty is whether the Appellants also had permanent homes available to them in Canada. If their Alberta living arrangements did not constitute permanent homes, they will be deemed to be residents of the US, and not Canada, for purposes of the Treaty and the Treaty analysis will end there.

(ii) If their Alberta living arrangements are found to have also been permanent homes available to them, then paragraph 2(a) requires the Court to next determine whether their "centres of vital interest", being the country with which their "personal and economic relations were closer", can be determined. If it can be determined they will be deemed to have been residents of that country, and not the other country, and the Treaty analysis will end there.

(iii) If their centres of vital interest cannot be determined, the Court must determine whether they had an "habitual abode" in either or both countries. If they had an habitual abode in one country and not in the other, they will be deemed to have been residents of the former country, and not the latter, and the Treaty analysis will end there.

(iv) If they had "habitual abodes" in both Canada and in the US, or in neither country, the Appellants will be deemed to have been residents of the US, and not residents of Canada, for purposes of the Treaty by virtue of their sole US citizenship and no further inquiry need be made.

D. If the Appellants are determined by the tie-breaker rules under "C" above to have been residents of Canada for purposes of the Treaty, after having first been found under "A" above to have been resident in Canada for purposes of the ITA, the result is they remain properly taxable as Canadian residents under the ITA and the Appellants are unsuccessful.

E. If the Appellants are determined by the tie-breaker rules under "C" above to have been residents of the US for purposes of the Treaty, then subsection 250(5) deems them not to be resident in Canada for purposes of the ITA and the Appellants are successful.

* + Paragraph 28 affords a good summary of Thomson’sdiscussion of residency.
  + Court found that the taxpayers were not residents in Canada, with their various ties being only insofar as was necessary for their contract work in Alberta:

Based upon the facts presented as summarized above, and the meanings given to the terms resident and ordinarily resident, I find that none of the Appellants were resident or ordinarily resident in Canada in the circumstances. They continued to have and maintain their extremely deep and extensive family, personal, business and financial ties to the US. They did not give up any of their ties to the US, except their physical presence while needed in Edmonton to fulfill their Syncrude obligations. Further, they virtually only took on such ties to Canada as were reasonably needed to fulfill the CCG business contract with Syncrude in an economically reasonable and commonsensical, practical manner such as (i) rented apartments with early termination provisions (ii) locally leased cars (iii) modest furnishings most all of which were donated to neighbourhood charitable thrift shops before leaving Canada; and (iv) single local chequing account used for local living expenses. They never intended to remain in Canada beyond the period of the Syncrude contract which, while renewed once, was intentionally kept to definite terms by the Appellants. (Elliott, at para 33)

* + Also emphasize the importance of examining residence on the specific facts – the test for residence for tax purposes is not synonymous with an outward appearance of residence:

A determination of residence depends upon and requires consideration of the overall particular facts of the individual involved. The fact that, from all outward appearances, the Appellants might each appear to other Edmontonians to live there in the same manner as others, is simply not the test. Similarly, the fact that a middle aged professional may be expected to have a more settled way of life and very different past habits of life than young university graduates moving out of their parents' homes and starting one of their first jobs does not mean I should ignore any such factual differences where they exist (though different factors may be given different weight in different cases). (Elliott, at para 34)

* + Government relied upon an argument that the taxpayers were sojourners – “to temporarily stay, visit, reside or remain, in a place for a time” (Elliott, at para 36).
    - Likely did not argue factual residence due to how the treaty tie-breaker analysis resolved: Canadian domestic law on residency would likely have destroyed chances of success for factual residency.
    - Is the more permanent nature of the taxpayer’s stay deleterious to the sojourner requirement?
      * No; other definitions of “sojourning” considered by the Court (Elliott, at paras 37–41) support a less constrained version of the definition. See e.g. para 40:

In the text "International Taxation in Canada" it is written: "A sojourner is someone who is physically present in Canada, but does not regard Canada "home" or intend to remain in Canada."

* + Also notes that sojourning is somewhat dependent on staying overnight in Canada – commuting is not captured:

Counsel for the Appellants relied upon R & L Food Distributors Ltd. v. Minister of National Revenue (1977), 77 D.T.C. 411 (T.R.B.) for the proposition that a US resident travelling to Canada each day to work in Canada and returning to the US each night is not sojourning. I accept that and agree that a day trip or a series of regular day trips is not a sojourn. However, there is a great factual gulf between a daily border town commuter and living in Edmonton.

* + Under s. 250(1) – the sojourner rule – each of the taxpayers was clearly deemed to be resident in Canada:

There is no dispute that the Appellants were living in Canada for 183 days or more each year on this basis, regardless of how travel days are counted.

Each of the Appellants is deemed to have been resident in Canada for purposes of the ITA in each of the years in question. (Elliott, at paras 44–45)

* + Section 250(5) gives effect to the treaty tie-breaker rules.

**Deemed non-resident**

**(5)** Notwithstanding any other provision of this Act (other than paragraph 126(1.1)(a)), a person is deemed not to be resident in Canada at a time if, at that time, the person would, but for this subsection and any tax treaty, be resident in Canada for the purposes of this Act but is, under a tax treaty with another country, resident in the other country and not resident in Canada.

* + Treaty tie-breaker rules clearly supported US residency, particularly center of vital interests.
    - “No single test” to determine centre of vital interests for the third tie-breaker rule.
    - Test is based on quality of interests and not quantity:

It is clear that closer does not mean more numerous. It is a relative not a mechanical or arithmetic concept. Closeness requires that serious attention be focused upon the depth and nature of the personal and economic relations/ties …

… “In determining his centre of vital interests, it is not enough to simply weigh or count the number of factors or connections on each side. The depth of the roots of one's centre of vital interests is more important than their number.” (Elliott, at paras 72–73)

* + Through this approach, found that for both taxpayers their centers of vital interest were the US.

Corporate Residency

Relevant ITA Provisions

* Section 250(4) is the starting rule for determining corporate residency.

**Corporation deemed resident**

**250(4)** For the purposes of this Act, a corporation shall be deemed to have been resident in Canada throughout a taxation year if

(a) in the case of a corporation incorporated after April 26, 1965, it was incorporated in Canada;

(b) in the case of a corporation that

(i) was incorporated before April 9, 1959,

(ii) was, on June 18, 1971, a foreign business corporation (within the meaning of section 71 of the Income Tax Act, chapter 148 of the Revised Statutes of Canada, 1952, as it read in its application to the 1971 taxation year) that was controlled by a corporation resident in Canada,

(iii) throughout the 10 year period ending on June 18, 1971, carried on business in any one particular country other than Canada, and

(iv) during the period referred to in subparagraph 250(4)(b)(iii), paid dividends to its shareholders resident in Canada on which its shareholders paid tax to the government of the country referred to in that subparagraph,

it was incorporated in Canada and, at any time in the taxation year or at any time in any preceding taxation year commencing after 1971, it was resident in Canada or carried on business in Canada; and

(c) in the case of a corporation incorporated before April 27, 1965 (other than a corporation to which subparagraphs 250(4)(b)(i) to 250(4)(b)(iv) apply), it was incorporated in Canada and, at any time in the taxation year or at any time in any preceding taxation year of the corporation ending after April 26, 1965, it was resident in Canada or carried on business in Canada.

* + For the scope of this course, only (a) and (c) are relevant.
    - Therefore, if a corporation is incorporated in Canada after 1965, it is deemed resident.
    - If incorporated prior to 1965, if it was resident or carried on business in Canada for any taxation year, it will be deemed resident.
* **Articles of Continuance** allow for one to take an existing corporation and bring it under the corporate law of another jurisdiction.
  + Articles of Incorporate to incorporate and Articles of Dissolution to dissolve.
  + Essentially analogous to giving up citizenship, but applied to a corporation.
  + Different procedures under different jurisdictions.
  + In the US, the same process is considered **re-domiciliation**.
* Section 250(5.1) governs the residency of a continued corporation.

**Continued corporation**

**250(5.1)** Where a corporation is at any time (in this subsection referred to as the “time of continuation”) granted articles of continuance (or similar constitutional documents) in a particular jurisdiction, the corporation shall

**(a)** for the purposes of applying this Act (other than subsection 250(4)) in respect of all times from the time of continuation until the time, if any, of continuation in a different jurisdiction, be deemed to have been incorporated in the particular jurisdiction and not to have been incorporated in any other jurisdiction; and

**(b)** for the purpose of applying subsection 250(4) in respect of all times from the time of continuation until the time, if any, of continuation in a different jurisdiction, be deemed to have been incorporated in the particular jurisdiction at the time of continuation and not to have been incorporated in any other jurisdiction.

* + If a corporation is continued into Canada, for the purposes of s. 250(4), the corporation is deemed to be incorporated in Canada and not in any other jurisdiction.
    - Even if the corporation was originally a US corporation, s. 250(5.1) deems that corporation to have always been incorporated in Canada.
* Section 253 provides an extended definition of “carrying on business” for the purposes of the ITA.

**Extended meaning of carrying on business**

**253** For the purposes of this Act, where in a taxation year a person who is a non-resident person or a trust to which Part XII.2 applies

(a) produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada whether or not the person exports that thing without selling it before exportation,

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

(c) disposes of

(i) Canadian resource property, except where an amount in respect of the disposition is included under paragraph 66.2(1)(a) or 66.4(1)(a),

(ii) property (other than depreciable property) that is a timber resource property, an option in respect of a timber resource property or an interest in, or for civil law a right in, a timber resource property, or

(iii) property (other than capital property) that is real or immovable property situated in Canada, including an option in respect of such property or an interest in, or for civil law a real right in, such property, whether or not the property is in existence,

the person shall be deemed, in respect of the activity or disposition, to have been carrying on business in Canada in the year.

* + A broad definition for “carrying on business”, especially combined with the definition of “business” already contained in the ITA.
    - However, “carrying on business” must generally be done through a permanent establishment; for treaty purposes, both of these elements are key for the taxpayer to receive benefits.
* Section 255 defines “Canada”:

**Canada**

**255** For the purposes of this Act, Canada is hereby declared to include and to have always included

(a) the sea bed and subsoil of the submarine areas adjacent to the coasts of Canada in respect of which the Government of Canada or of a province grants a right, licence or privilege to explore for, drill for or take any minerals, petroleum, natural gas or any related hydrocarbons; and

(b) the seas and airspace above the submarine areas referred to in paragraph 255(a) in respect of any activities carried on in connection with the exploration for or exploitation of the minerals, petroleum, natural gas or hydrocarbons referred to in that paragraph.

* + Canada considers anything offshore to be considered as part of Canada if certain resources are being exploited.
    - If, under international law, Canada has claimed jurisdiction to issue licenses to certain offshore resources, income earned from the extraction of those resources is considered to be earned in Canada.

***Birmount Holdings Ltd v R*** ([FCA 1978](https://nextcanada.westlaw.com/Document/I10b717ce598c63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Central Management and Control Test for Corporate Residence

* Facts:
  + Birmount is incorporated in Canada in 1960, which is prior to the deeming rule for corporate residency set out in s. 250(4).
    - Not deemed to be resident in Canada by virtue of incorporation.
    - All three directors of corporation were in Toronto, with the sole shareholder a resident of France.
* Holdings:
  + Question was whether Birmount was a resident of Canada.
  + Established common law rule is that a corporation is resident where its **central management and control** resides (Birmount, para 29, citing De Beers).
  + Corporate residence is not determined by its shareholders’ residence (Birmount, para 32, citing Bedford Overseas Freighters), but rather residency of whomever exercises central management and control.
    - Usually the directors, but if someone other than its directors exercise management and control of the company, the residence of those parties may be important.
    - **Unanimous shareholder agreements** are crucial for determining this, if such agreements have pulled all power out of the directors and into the shareholders, or any other declared party.
  + As provided in the headnote:

Because the real and only business of the company was carried on in Canada and it "kept house" in Canada and its central management and control was in Canada, the company was at all relevant times resident in Canada. Also, it was open to the trial judge to find that the company was deemed to be resident in Canada in 1972 because it carried on business in Canada.

***Crown Forest Industries Ltd v Canada*** ([TCC 1992](https://nextcanada.westlaw.com/Document/I10b717ccea1f63f0e0440003ba0d6c6d/View/FullText.html?docFamilyGuid=I503095f0723a11d7947cc0bc28d0837a&transitionType=History&contextData=%28sc.Default%29); [FCA 1993](https://nextcanada.westlaw.com/Document/I10b717ce59d763f0e0440003ba0d6c6d/View/FullText.html?docFamilyGuid=I5171de6072d011d7947cc0bc28d0837a&transitionType=History&contextData=%28sc.Default%29); [SCC 1995](https://nextcanada.westlaw.com/Document/I10b717d04f4263f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Inferring Residency from Assessments; Effects of Non-Residency on Taxation (See supra for Discussion of Treaty Interpretation; infra for Treaty Shopping)

* Facts:
  + CFI controls Crown Forest, and Norsk was incorporated in Bahamas but operated in US.
    - Crown Forest paid a fee to Norsk, and was subject to a withholding tax.
      * Crown Forest withheld at a lesser amount, with the opinion that Norsk was not a US resident.
* Holdings:
  + Norsk was not a resident of the US for treaty purposes, on the basis that they were not taxable on the basis of their residency, domicile, or place of incorporation.
    - Rather, Norsk was taxed because the source of the income that they earned was in the US.
      * Taxed on the basis of source rather than on basis of residence.
      * Implies that if Norsk had carried on business in the US and carried on business in Canada, the US would have taxed Norsk on the US source income but not the Canadian.
        + Consequently, Norsk was not resident and the treaty relief could not apply.
  + If Norsk was taxed under one of Article IV’s grounds (“domicile, residence, citizenship, place of management, place of incorporation”), then it should have been taxed on worldwide income, which it was not.

Residency of Trusts

Relevant ITA Provisions

* Section 250(2) provides that even if an individual ceases to be resident mid-way through a taxation year, they will continue to be considered resident for the portion of the year they were resident.

**Idem**

**250(2)** Where at any time in a taxation year a person described in paragraph (1)b), (c) or (d) ceases to be a person so described, or a person described in paragraph (1)(d.1) ceases to be a member of the overseas Canadian Forces school staff, that person shall be deemed to have been resident in Canada throughout the part of the year preceding that time and the spouse or common-law partner and child of that person who by reason of paragraph (1)(e) or (f) would, but for this subsection, be deemed to have been resident in Canada throughout the year shall be deemed to have been resident in Canada throughout that part of the year.

* + Important for trusts, which can end mid-way through the year.

***Thibodeau Family Trust v The Queen*** ([FCTD 1978](https://nextcanada.westlaw.com/Document/I10b717d05a2263f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Classical Rule for Trust Residency: Residence of Trustees Determinative

* Facts:
  + Trust was worded so that decisions were to be made by a majority.
* Holdings:
  + Trust resident in Bermuda.
  + Trusts are not analogous to corporations in residency: trustees cannot delegate their authority and trusts cannot be a dual residence – residence of trust is the residence of the trustees.
    - The classical rule for many years until Garron.

***Garron Family Trust (Trustee of) v R*** (sub nom. ***St. Michael Trust Corp, as Trustee of the Fundy Settlement v The Queen***) ([SCC 2012](https://nextcanada.westlaw.com/Document/Ibd7d148842f56321e0440021280d79ee/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Central Management and Control Test Applies for Trust Residency

* Facts:
  + Several corporations incorporated in the Caribbean serving as trustees for the trust.
    - Under the old rules, the residence of the trustees determined the residence of the trust.
    - Corporate trustees were originally operated by PWC, but were ultimately transferred to a bank.
  + Settlor and protector were friends of Mr. Garron.
    - **Protector** watches the trustees to ensure that the trustees carry out the wishes of the **settlor** – the party who confers the trust property.
  + Freeze executed and then interests sold in 1972.
    - The CRA assessed the trust as resident in Canada and thus the gains from the sale of the interests taxable in Canada.
* Holdings:
  + At trial, Woods J held that the central management and control test should apply for trusts, as it does for corporations.
    - Residence of trustee is an applicable test if the trustees are compliant with the fiduciary obligations, rather than adopting a policy of inactivity.

I conclude, then, that the judge-made test of residence that has been established for corporations should also apply to trusts, with such modifications as are appropriate. That test is "where the central management and control actually abides. (Garron(TCC), at para 162)

* + Before Garron, the operating principle was that corporations are legal entities, and accordingly, the central management and control of that entity is determinative of that entity.
    - A trust is not a legal entity, but rather a relationship between parties.
      * Therefore, since the trust did not exist independently at law, the best test to determine residency is where the trustees are resident.
  + Justice Woods provided the following rationale for adopting this test:

First, the basis for applying this test to corporations is equally applicable in a trust context. In one of the most quoted passages in Canadian tax jurisprudence, the reasons for adopting this test were stated by Lord Loreburn in *De Beers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455 (U.K. H.L.), at 458:

... In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company …

Although there are significant differences between the legal nature of a trust and corporation, from the point of view of determining tax residence, the characteristics are quite similar. The function of each is, at a basic level, the management of property.

Second, adopting a similar test of residence for trusts and corporations promotes the important principles of consistency, predictability and fairness in the application of tax law. (Garron(TCC), at paras 158–160)

* + The role of a trust is to be a steward of property, and that stewardship task is conducted through human parties, similar to how corporations function.
  + Test for central management and control upheld at the SCC.

As with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where "its real business is carried on" (De Beers, at p. 458), which is where the central management and control of the trust actually takes place. As indicated, the Tax Court judge found as a fact that the main beneficiaries exercised the central management and control of the trusts in Canada. She found that St. Michael had only a limited role — to provide administrative services — and little or no responsibility beyond that (paras. 189-90). Therefore, on this test, the trusts must be found to be resident in Canada. This is not to say that the residence of a trust can never be the residence of the trustee. The residence of the trustee will also be the residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident. These, however, were not the facts in this case.

We agree with Woods J. that adopting a similar test for trusts and corporations promotes "the important principles of consistency, predictability and fairness in the application of tax law" (para. 160). As she noted, if there were to be a totally different test for trusts than for corporations, there should be good reasons for it. No such reasons were offered here. (Garron (SCC), at paras 15–16)

Changing Residence

Relevant ITA Provisions

* Section 128.1 governs immigration: when a taxpayer immigrates, they are deemed to dispose, immediately before immigrating, of all of their property owned except for **taxable Canadian property** – real property, natural resource rights – **business inventory** for a business carried on in Canada, and **goodwill** (Class 14.1 property).

**Immigration**

**128.1(1)** For the purposes of this Act, where at a particular time a taxpayer becomes resident in Canada,

**Year-end, fiscal period**

**(a)** where the taxpayer is a corporation or a trust,

(i) the taxpayer’s taxation year that would otherwise include the particular time shall be deemed to have ended immediately before the particular time and a new taxation year of the taxpayer shall be deemed to have begun at the particular time, and

(ii) for the purpose of determining the taxpayer’s fiscal period after the particular time, the taxpayer shall be deemed not to have established a fiscal period before the particular time;

**Deemed disposition**

**(b)** the taxpayer is deemed to have disposed, at the time (in this subsection referred to as the “time of disposition”) that is immediately before the time that is immediately before the particular time, of each property owned by the taxpayer, other than, if the taxpayer is an individual,

(i) property that is a taxable Canadian property,

(ii) property that is described in the inventory of a business carried on by the taxpayer in Canada at the time of disposition,

(iii) property included in Class 14.1 of Schedule II to the Income Tax Regulations, in respect of a business carried on by the taxpayer in Canada at the time of disposition, and

(iv) an excluded right or interest of the taxpayer, other than an interest described in paragraph (k) of the definition excluded right or interest in subsection (10),

(v) [Repealed, 2001, c. 17, s. 123]

for proceeds equal to its fair market value at the time of disposition;

**Deemed acquisition**

**(c)** the taxpayer shall be deemed to have acquired at the particular time each property deemed by paragraph 128.1(1)(b) to have been disposed of by the taxpayer, at a cost equal to the proceeds of disposition of the property;

* + Taxable Canadian property is taxable regardless of whether one is a resident or non-resident.
  + Inventory for a business carried on in Canada will still be taxed in Canada if it is part of carrying out of business in Canada through a permanent establishment; goodwill is not taxable for the same.
* Section 128.1(4) governs emigration, with narrower transitional rules than s. 128.1(1).

**Emigration**

**128.1(4)** For the purposes of this Act, where at a particular time a taxpayer ceases to be resident in Canada,

**Year-end, fiscal period**

**(a)** where the taxpayer is a corporation or a trust,

(i) the taxpayer’s taxation year that would otherwise include the particular time shall be deemed to have ended immediately before the particular time and a new taxation year of the taxpayer shall be deemed to have begun at the particular time, and

(ii) for the purpose of determining the taxpayer’s fiscal period after the particular time, the taxpayer shall be deemed not to have established a fiscal period before the particular time;

**Fiscal period**

**(a.1)** if the taxpayer is an individual (other than a trust) and carries on a business at the particular time, otherwise than through a permanent establishment (as defined by regulation) in Canada,

(i) the fiscal period of the business is deemed to have ended immediately before the particular time and a new fiscal period of the business is deemed to have begun at the particular time, and

(ii) for the purpose of determining the fiscal period of the business after the particular time, the taxpayer is deemed not to have established a fiscal period of the business before the particular time;

**Deemed disposition**

**(b)** the taxpayer is deemed to have disposed, at the time (in this paragraph and paragraph (d) referred to as the “time of disposition”) that is immediately before the time that is immediately before the particular time, of each property owned by the taxpayer other than, if the taxpayer is an individual,

(i) real or immovable property situated in Canada, a Canadian resource property or a timber resource property,

(ii) capital property used in, property included in Class 14.1 of Schedule II to the Income Tax Regulations in respect of or property described in the inventory of, a business carried on by the taxpayer through a permanent establishment (as defined by regulation) in Canada at the particular time,

(iii) an excluded right or interest of the taxpayer,

(iv) if the taxpayer is not a trust and was not, during the 120-month period that ends at the particular time, resident in Canada for more than 60 months, property that was owned by the taxpayer at the time the taxpayer last became resident in Canada or that was acquired by the taxpayer by inheritance or bequest after the taxpayer last became resident in Canada, and

(v) any property in respect of which the taxpayer elects under paragraph (6)(a) for the taxation year that includes the first time, after the particular time, at which the taxpayer becomes resident in Canada,

for proceeds equal to its fair market value at the time of disposition, which proceeds are deemed to have become receivable and to have been received by the taxpayer at the time of disposition;

* + Comparable to immigration, emigration includes as foreign resource property as taxable Canadian property.
    - Business carried on is also strictly from a permanent establishment.

Entities

Concept of an Entity in the United States

* The most basic form of entity is an LLC – a limited liability vehicle which may be treated as either a corporation or a **fiscally transparent entity**.
  + If the LLC is a corporation, it has a separate identity for tax purposes and is taxable.
  + If the LLC is not a corporation, it is fiscally transparent:
    - If owned by one person, it is considered a proprietorship.
    - If owned by two or more persons, it is considered a partnership.
  + When an LLC is first incorporated, an LLC is fiscally transparent for tax purposes.
    - This requires “check[ing] the box” – filing a tax return and checking a box electing the LLC as a corporation.
      * Without checking the box, the LLC is fiscally transparent and is either a proprietorship or a partnership.
* An **S-Corp** is a limited liability business corporation.
* A **C-Corp** is also a limited liability business corporation, but can be owned by a non-resident.
  + The main difference between the S-Corp and the C-Corp is who may own it.
    - S-Corps may only be owned by US persons, while C-Corps can be owned by *C*anadians (C for Canadians, although the C in the term is not actually for Canadian).
* The **general partnership (GP)** is two or more persons carrying on business in common with a view to a profit (i.e. the common law definition for a partnership in Canada).
  + Partnerships have joint and several liability.
    - Several liability means an individual is only liable.
    - Joint liability means all partners are liable for everyone else.
  + The general partnership has joint and several liability.
* The **limited partnership (LP)** is a partnership with limited liability.
  + Must require two or more persons carrying on business, with a **general partner** and one or more **limited partners**.
    - Under partnership law, the general partner assumes responsibility for all liability.
      * In practice, the general partner is usually a corporation, which therefore imports limited liability by virtue of being a corporation.
        + The limited partners are then individuals.
        + Allows for maximum flow-through of income while maintaining liability shields where possible.
* A **limited liability partnership (LLP)** is a partnership of professionals.
  + Only the professional who provided a service which gave rise to damages will be liable.
* A **limited liability limited partnership** **(LLLP)** is only used in several US states, and can protect the general partner from liability in addition to the limited partners.
  + The general partner, so long as they only manage the business, enjoys limited liability.
  + Limited partners have no say in management.
* In international tax, the most commonly encountered entities are LLC’s, C-Corps, General Partnerships, and Limited Partnerships.
* One common set-up concerns a CanCo which wants to invest in the USA. How should that be done?
  + With an LLC, the result will be a transparent entity taxable in Canada.
    - When filing the Canadian tax return, say the LLC made a $1 million profit.
      * Due to fiscal transparency, you put that in Canada such that there is $1 million in profit.
        + The CRA will look at this and ask how exactly income is flowing through from a corporation; you say it is fiscally transparent; the CRA will ask “fiscally transparent where”; and you respond “… fiscally transparent in the USA”.
        + US will examine this and require a US tax return to be filed and US taxes payable on the Canadian corporation.

No foreign tax credits until a dividend is paid out of the LLC into Canada.

The LLC did not pay tax; the CanCo did.

* + - * The result of using an LLC is exposure to a wide swathe of tax liability and inability to take advantage of international relief.
      * If an LLC is used, be sure to check the box so it is an independent entity.
        + But at that point, why not just use a C-Corp, which has fewer expenses.
      * The LLC is fiscally transparent, so in addition to the issues with the recognition of income at different periods of time and being unable to claim credits, the LLC is not an entity, is not resident in the US, and does not qualify for treaty relief (see further *infra*).
        + CanCo has no foreign source income to apply credits against.

One can only claim foreign credits against income from the same country.

US required CanCo to pay money through a proprietor, and then Canada recognizes no foreign income.

* + - * + When the LLC then pays dividends, it is not paying out of exempt dividends, but rather taxable dividends, because the LLC has not been taxed yet.

The LLC was not taxed, the CanCo was.

* + With a C-Corp, it will be treated as a foreign affiliate, and when dividends are paid, it will be taxed in Canada with withholding taxes, surplus, and exempt surplus (*infra*).
  + With a general partnership, any profit earned at the partnership level will automatically flow-through to Canada.
  + With a limited partnership, a liability shield will be put into place while retaining the flow-through of income.

II: Taxation of Non-Resident Income

A: Active Income Earned by Non-Residents – Employment Income

Non-Resident Employment in Canada

Relevant ITA Provisions

* Section 2 (i.e. Division A) of the ITA reads as follows:

**Tax payable by persons resident in Canada**

**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.

**Taxable income**

**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.

**Tax payable by non-resident persons**

**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.

* + Consider five types of income, calculated under Division B with the deductions permitted under Division C.
  + “Residence” is different for purposes of the ITA and for the purposes of the US-Can Tax Treaty.
    - Domestically, a person may be resident factually, ordinarily resident, or deemed to be resident.
    - Under the treaty, residence of a person is determined differently.
  + Section 2(3) subjects non-residents to tax, if they fall within one of the three activities listed in the subsections:
    - (a) – Employed in Canada.
    - (b) – Carried on a business in Canada.
    - (c) – Disposed of a **taxable Canadian property**.
* A person only needs to pay tax under their domestic tax legislation; if the treaty subjected a taxpayer to more tax, they are not required to pay that higher sum – treaties are meant only to relieve double taxation, not to facilitate more tax.
* Section 115, part of Division D, details taxable income for a non-resident.

**Non-resident’s taxable income in Canada**

**115(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

(a) the non-resident person had no income other than

(i) incomes from the duties of offices and employments performed by the non-resident person in Canada and, if the person was resident in Canada at the time the person performed the duties, outside Canada,

(ii) incomes from businesses carried on by the non-resident person in Canada which, in the case of the Canadian banking business of an authorized foreign bank, is, subject to this Part, the profit from that business computed using the bank’s branch financial statements (within the meaning assigned by subsection 20.2(1),

(iii) taxable capital gains from dispositions described in paragraph 115(1)(b),

(iii.1) the amount by which the amount required by paragraph 59(3.2)(c) to be included in computing the non-resident person’s income for the year exceeds any portion of that amount that was included in computing the non-resident person’s income from a business carried on by the non-resident person in Canada,

(iii.2) amounts required by section 13 to be included in computing the non-resident person’s income for the year in respect of dispositions of properties to the extent that those amounts were not included in computing the non-resident person’s income from a business carried on by the non-resident person in Canada,

(iii.21) the total of all amounts, each of which is an amount included under subparagraph 56(1)(r)(v) or section 56.3 in computing the non-resident person’s income for the year,

(iii.3) in any case where, in the year, the non-resident person carried on a business in Canada described in any of paragraphs (a) to (g) of the definition principal-business corporation in subsection 66(15), all amounts in respect of a Canadian resource property that would be required to be included in computing the non-resident person’s income for the year under this Part if the non-resident person were resident in Canada at any time in the year, to the extent that those amounts are not included in computing the non-resident person’s income by virtue of subparagraph 115(1)(a)(ii) or 115(1)(a)(iii.1),

…

(b) the only taxable capital gains and allowable capital losses referred to in paragraph 3(b) were taxable capital gains and allowable capital losses from dispositions, other than dispositions deemed under subsection 218.3(2), of taxable Canadian properties (other than treaty-protected properties), and

…

* + Note that s. 115(1)(a)(i), and other provisions, read “income***s***”.
  + Taxable Canadian property is real property, as well resource and timber property, and shares of a corporation if at least 50% of the shares’ value is derived from real property.
* Section 115(3) addresses non-resident aircraft pilots specifically:

**Non-resident employed as aircraft pilot**

**115(3)** For the purpose of applying subparagraph (1)(a)(i) to a non-resident person employed as an aircraft pilot, income of the non-resident person that is attributable to a flight (including a leg of a flight) and paid directly or indirectly by a person resident in Canada is attributable to duties performed in Canada in the following proportions:

(a) all of the income attributable to the flight if the flight departs from a location in Canada and arrives at a location in Canada;

(b) one-half of the income attributable to the flight if the flight departs from a location in Canada and arrives at a location outside Canada;

(c) one-half of the income attributable to the flight if the flight departs from a location outside Canada and arrives at a location in Canada; and

(d) none of the income attributable to the flight if the flight departs from a location outside Canada and arrives at a location outside Canada.

* + Stems from a 2005 amendment to the ITA, in response to the series of cases discussed *infra*.

Treaty Relief

* In the Can-US Tax Treaty, two Articles detail taxation of non-residents in one of the Contracting States by that State.
  + Article XV details “Income from Employment”:

**Article XV**

**Dependent Personal Services**

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 (Canada) a Contracting State in respect of an employment shall be taxable only in (Canada) that State unless the employment is exercised in the (US) other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that (US) other State.

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

(a) such remuneration does not exceed ten thousand dollars ($10,000) in the currency of (the US) that other State; or

(b) the recipient is present in (the US) that 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 not paid by, or on behalf of, a person who is a resident of (the US) that other State and is not borne by a permanent establishment in (the US) 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.

* + From Article XV(1), if a Canadian resident is employed in Canada, only Canada can tax that person, unless part of the employment is in the United States.
  + Article XV(2) allows a state to tax their residents on employment income they earn in the other state.
    - If the person has part of their employment in the United States, Canada may tax only up to **$10,000** (US) of the remuneration from that employment in the US (Art XV(2)(a)).
    - Article XV(2)(b) allows for a state to tax their own residents when said residents earn employment income in the other state, if that income is not paid for by one of the other state’s residents, or borne by a permanent establishment of one of the other state’s residents, and the resident is in the other state for less than 183 days.
      * “On behalf of” means that the corporation in one state cannot pay the person and then is subsequently reimbursed by the corporation in the other state.
      * “Permanent establishment” is a fixed place of business.
      * “Borne by” means deducted by.
      * Between the two, this means the amount cannot be deducted by a permanent establishment in the other state.
      * E.g. If a US resident earns employment income in Canada, they are only taxable in Canada if the amounts are more than $10,000.
    - In totality, Article XV(2) allows Canada to tax a Canadian resident employed in the US, if their US income is less than **$10,000** (US), if the Canadian is in the US for less than 183 days, and remuneration is not paid by, or on behalf of, a US resident and is not borne by a US permanent establishment.
      * If a Canadian resident earns employment income in the US, they are only taxable by the US if remuneration is more than $10,000, or they are in the US for more than 183 days and their salary is paid by or on behalf of a US resident or by a permanent establishment in the US.
  + Say A, a Canadian, provides services to a US PC for four days.
    - Has not been there for longer than 183 days.
    - The US PC cannot pay A, nor can the Can PC pay A on the US PC’s behalf.
      * However, say the Can PC pays $1,000 to A for the 4 days and reimburses their expenses.
        + The US PC then pays $3,000 to the Can PC. Is the reimbursement “borne by” a US permanent establishment?

In US tax law, this would be borne by a permanent establishment.

In Canadian tax law, administrative materials have indicated that this would not be considered to be borne by a permanent establishment.

* + - * + Can the US tax the $1,000?

It depends.

* + Article XV(3) allows the resident state to tax transitory employees.
* Article XVI concerns “Artistes and Athletes”.

**Article XVI**

**Artistes and Athletes**

1. Notwithstanding the provisions of Articles VII (Business Profits) and XV (Income From Employment), 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.

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), and XV (Income from Employment), 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 person 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 State; or

(b) a team described in subparagraph (a).

4. Notwithstanding the provisions of Articles VII (Business Profits) and XV (Income from Employment) 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 (Income from Employment)) 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.

* + Article XVI(1) allows for the US to tax any income over **$15,000** (US) which is earned by a Canadian artist or athlete performing in the US.
    - If the Canadian earns less than **$15,000**, then they are only taxed in Canada.
  + Article XVI(2) would apply for artists or athletes operating under an agency or promoter agreement or through a corporation.
    - If some of the income accrues to another party, then the state in which the services were performed can tax that income.
    - The human actor performs the services which are contracted between the corporation and the client.
      * The income earned in those circumstances will be taxable in the US.
  + Article XVI(3) basically applies only to hockey, football, baseball, and perhaps soccer, and precludes the application of the previous two Articles.

Matrix of Analysis for Treaty Relief for Employment Income

* Start with Article XV.
  + Article XVI is a sub-set, due to having paramountcy.
  + Income can be taxed in the other state if activities are carried out in that other state.
    - E.g. Employment income for a Canadian employee is taxable in the US if carried out in the US.
  + Treaty Relief – No tax is payable to the US if:
    - The Canadian’s income is less than $**10,000**, or
    - If the Canadian is in the US for less than 183 days, and the monies are not paid by (borne by) a US resident or a permanent establishment in the US.
      * E.g. The US can tax a Canadian resident earning more than $10,000 of US employment income, or if they are in the US for more than 183 days and their remuneration is paid by or borne by a US resident or a permanent establishment in the US.
* Then apply Article XVI if the person is an artiste or athlete.
  + Article XVI(1) essentially overrides Article XV in the numerical limit, and entirely removes the 183 days exception: a Canadian artiste or athlete is only taxable on their employment income in the US if they earn more than **$15,000**, and is taxable only in Canada if they earn less than $15,000.
  + Article XVI(2) notes that if the income is accruing to another person, then the state in which the activities are performed may tax that income.
    - Exception where the performer does not participate (share) in that accrued income: such income will thereby be considered not to accrue to that other person.

Case Law – Apportionment of Airplane Pilot Income

***Austin v R*** ([TCC 2004](https://nextcanada.westlaw.com/Document/I10b717d5112763f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default)#sk=1.fqExpJ)) – Gain Method Appropriate for Airplane Pilot Income

* Facts:
  + Austin allocates income to each country based on the ratios of games in each country – the **gain method**.
    - Austin was only paid if he played in a game, and allocated his income appropriately.
  + CRA allocated income to the US based on the number of days that Austin was actually present in the US – the **time method**.
    - 100% of practice time is spent in Canada, and 70% of games in Canada.
* Holdings:
  + The TCC held that the gain method was more appropriate, because while all of the necessary work occurred in Canada, Austin would not be paid for that work if he did not play in the game in the US.
    - Not a perfect approximation, but more appropriate than the Minister’s use of actual time spent physically present in each country.

The Appellant's pay was divided into 18 parts, one part for each game and, as stated, if he was cut, or did not play a game for other reasons other than injury, he did not get paid.

…

I believe it is overly restrictive to find that the Appellant, who plays three or four of 18 games in the U.S. in a one-year period, must have income calculated based on his time of six or eight days in the U.S. over the number of total days in the season. The ratio of three over 18 and four over 18 is far more realistic. It is not perfect but more reasonable.

While I am overlooking the Respondent's submission that the Appellant, if injured, would be paid under certain circumstances for not playing, this fact does not justify the extraordinary imbalance using the Minister's ratios. I was presented with the Minister's allocation method and with the Appellant's. I find the Appellant's far more reasonable and I was left with no other formula for a compromise. (Austin, paras 10, 13, 14)

* + Does Article XVI(3) apply?
    - The Article was added in 2007, while Austin was heard in 2004; likely still would not matter.
      * Austin earned more than $15,000, and no issue with how the monies was paid out that could implicate Article XVI(2).
      * Neither Articles XVI(1) & XVI(2) would have applied, so the exclusionary rule provided in Article XVI(3) would not have any effect.

***Sutcliffe v R*** ([TCC 2005](https://nextcanada.westlaw.com/Document/I10b717ee987063f0e0440003ba0d6c6d/View/FullText.html?navigationPath=Search%2Fv3%2Fsearch%2Fresults%2Fnavigation%2Fi0ad7140b00000168c1b4eeb76977d846%3FNav%3DMULTIPLECITATIONS%26fragmentIdentifier%3DI10b717ee987063f0e0440003ba0d6c6d%26startIndex%3D1%26contextData%3D%2528sc.Search%2529%26transitionType%3DUniqueDocItem&listSource=Search&listPageSource=11011e37bb9da6dfaa0519d5c544a9a1&list=MULTIPLECITATIONS&rank=0&sessionScopeId=14cab120e1dd6223754e9e1360556e7a8cd2d9a600d08deb0ebf472ae5c38300&originationContext=NonUniqueFindSelected&transitionType=UniqueDocItem&contextData=%28sc.Search%29)) – More Reasonable Apportionment Formula Prevails; Pre-Section 115(3) Standards for Apportionment

* Facts:
  + Sutcliffe was an Air Canada pilot.
    - Some of the flight path of his domestic flights flew over the US, and thus became employment in the US.
    - The CRA apportioned Sutcliffe’s income based on one formula, and Sutcliffe through another formula.
* Holdings:
  + Appeal was allowed because neither the Tax Treaty and the ITA provide an apportionment formula.
  + If the taxpayer and the Minister both provide apportionment formulas, the more reasonable formula prevails.
    - If both formulas are reasonable, then the taxpayer’s formula prevails.
  + The Court considered only the Minister’s formula as reasonable:

The evidence of the appellant focused on flaws with the Agency's assumptions used in apportioning remuneration to Canada. In considering differing methods of apportionment, though, the question is not whether there are flaws with a particular method. The question is which of the parties' methods is more reasonable.

In comparing the two methods proposed by the parties, it is clear that the Minister's approach results in a much closer approximation than the approach suggested by the appellant.

Moreover, the appellant has not provided any evidence that would support a more accurate allocation. It is not sufficient for the appellant to establish that the Minister's apportionment is inaccurate. He has not provided any reasonable basis to vary the assessments as they relate to international flights.

* + The Court applied the following standards (as summarized in Price, *infra*):

The income earned by the pilot in respect of the portion of a domestic flight flown in Canadian airspace is income earned in Canada.

The income earned by the pilot in respect of the portion of an international flight flown in Canadian airspace is income earned in Canada;

The income earned by the pilot in respect of remuneration paid by the airline company that is not related to specific duties, such as vacation and sickness pay, should be allocated on a pro-rata basis to duties performed in Canada.

* Today, s. 115(3), added in 2013, provides clear apportionment formulas for aircraft pilots.

***Price v R*** ([TCC 2011](https://nextcanada.westlaw.com/Document/Iaf9dba371b446c02e0440021280d79ee/View/FullText.html?listSource=Foldering&originationContext=clientid&transitionType=MyResearchHistoryItem&contextData=%28oc.UserEnteredCitation%29&VR=3.0&RS=WLCA1.0)) – Apportionment Follows Contract; Gain Method

* Facts:
  + The contract with Air Canada pilots are that pilots are paid for each minute they are flying.
  + Price was an Air Canada pilot resident in Bermuda.
    - Dispute over how to apportion income.
* Holdings:
  + Most reasonable method of allocation is to follow the allocation method set out in the employment contract.
  + Layover is a condition of employment with no pay, and thus does not count as a condition of employment which justifies remuneration and can be used to count time:

Being away from home on layovers might be a condition of employment, but the pilot was paid based on flight time only. Even if it is a condition of employment, it does not mean it is a condition of employment for which the pilot is remunerated.

* + Best way to allocate income is as in Austin, and to follow the pay structure in the employment contract:

I conclude that the most reasonable method is the one which reflects the pay structure contained in the contract of employment … The Appellant's situation of being paid per flying minutes is analogous to the situation of Mr. Austin.

* + The Court adopted the holdings in Sutcliffe as to the necessary connection between remuneration and services:

With respect, I find the Minister's position more convincing. The expression "income from duty of employment of offices and employments" should be given a broad meaning as stated in Sutcliffe as follows:

…

The connection between remuneration paid and services rendered enables employers to deduct remuneration paid and requires employees to be taxed on it. I reject the argument of the appellant that some portion of the remuneration has no income-earning nexus in Canada.

An income is taxable in Canada pursuant to section 115 of the Act as long as a nexus can be established with the performance of a duty in Canada.

* + The Court also provided several comments on apportionment for Air Canada pilots, which were subsequently implemented in s. 115(3):

It would be a blessing to bring an end to all the endless maneuvering. I would venture to say that all A/C pilots are Canadian citizens that they receive salary income from their Canadian employer. Their place of employment is Canada and that their home base is Canada from where their flights start and end.

Many have quite legally taken advantage of the Income Tax Act, particularly section 115, to substantially reduce their Canadian tax liability by becoming non-residents of Canada. This is entirely within the ambit of the legislation. A problem arises with the overly aggressive maneuvering to arrive at the lowest possible percentage for duties performed in Canada and for other amounts such as disability payments.

B: Active Income Earned by Non-Residents – Business Income

Active Income Earned by Non-Residents – Carrying on Business in Canada

Relevant ITA Provisions and Regulation Provisions

* Section 2(3)(b) (*supra*) allows for taxation of a non-resident if they have carried on business in Canada.
* Supplementing that, s. 4(1)(b) reads as follows:

**Income or loss from a source or from sources in a place**

**4 (1)** For the purposes of this Act,

…

(b) where the business carried on by a taxpayer or the duties of the office or employment performed by a taxpayer was carried on or were performed, as the case may be, partly in one place and partly in another place, the taxpayer’s income or loss for the taxation year from the business carried on, or the duties performed, by the taxpayer in a particular place is the taxpayer’s income or loss, as the case may be, computed in accordance with this Act on the assumption that the taxpayer had during the taxation year no income or loss except from the part of the business that was carried on in that particular place or no income or loss except from the part of those duties that were performed in that particular place, as the case may be, and was allowed no deductions in computing the taxpayer’s income for the taxation year except such deductions as may reasonably be regarded as wholly applicable to that part of the business or to those duties, as the case may be, and except such part of any other deductions as may reasonably be regarded as applicable thereto.

* + Amount of income which is reported in Canada pertains to such part which is attributable to Canada.
    - Say Mary works 10 days in the US, and earns $15,000 in that time.
      * Mary is only taxable in Canada on the portion attributable to Canada, per s. 4(1)(b), allocated according to some reasonable basis.
* Section 248(1) provides a definition for “business”:

***business*** includes a profession, calling, trade, manufacture or undertaking of any kind whatever and, except for the purposes of paragraph 18(2)(c), section 54.2, subsection 95(1) and paragraph 110.6(14)(f), an adventure or concern in the nature of trade but does not include an office or employment …

* + A person is “carrying on business” if they are in a business in Canada.
  + An adventure or concern in the nature of trade is income from a non-active business, but which is still considered business income.
    - Critical factor is whether the purchaser intended to resell, even if no activity or business was actually carried out.
    - E.g. Purchasing raw land or commodities to resell.
* Section 253 broadens the meaning “carrying on business”:

**Extended meaning of carrying on business**

**253** For the purposes of this Act, where in a taxation year a person who is a non-resident person or a trust to which Part XII.2 applies

(a) produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada whether or not the person exports that thing without selling it before exportation,

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

(c) disposes of

(i) Canadian resource property, except where an amount in respect of the disposition is included under paragraph 66.2(1)(a) or 66.4(1)(a),

(ii) property (other than depreciable property) that is a timber resource property, an option in respect of a timber resource property or an interest in, or for civil law a right in, a timber resource property, or

(iii) property (other than capital property) that is real or immovable property situated in Canada, including an option in respect of such property or an interest in, or for civil law a real right in, such property, whether or not the property is in existence,

the person shall be deemed, in respect of the activity or disposition, to have been carrying on business in Canada in the year.

* + Section 253(b) includes sales facilitated through an agent or employee outside of Canada in the definition.
* Regulation 805 creates a carve-out for non-residents who carry out business in Canada through a permanent establishment, such that the income from that business is subject to the lower Part I rates rather than Part XIII:

**Other Non-Resident Persons**

**805** Subject to section 802, every non-resident person who carries on business in Canada is taxable under Part XIII of the Act on all amounts otherwise taxable under that Part except those amounts that

(a) may reasonably be attributed to the business carried on by the person through a permanent establishment (within the meaning assigned by section 8201) in Canada; or

(b) are required by subparagraph 115(1)(a)(iii.3) of the Act to be included in computing the person’s taxable income earned in Canada for the year.

* Regulation 8201 provides a definition of “permanent establishment”:

**Permanent Establishments**

**8201** For the purposes of subsection 16.1(1), the definition outstanding debts to specified non-residents in subsection 18(5), subsections 100(1.3) and 112(2), the definition qualified Canadian transit organization in subsection 118.02(1), subsections 125.4(1) and 125.5(1), the definition taxable supplier in subsection 127(9), subparagraph 128.1(4)(b)(ii), paragraphs 181.3(5)(a) and 190.14(2)(b), section 233.8, the definitions Canadian banking business and tax-indifferent investor in subsection 248(1) and paragraph 260(5)(a) of the Act, a permanent establishment of a person or partnership (either of whom is referred to in this section as the person) means a fixed place of business of the person, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse if the person has a fixed place of business and, where the person does not have any fixed place of business, the principal place at which the person’s business is conducted, and

(a) where the person carries on business through an employee or agent, established in a particular place, who has general authority to contract for the person or who has a stock of merchandise owned by the person from which the employee or agent regularly fills orders, the person shall be deemed to have a permanent establishment at that place,

(b) where the person is an insurance corporation, the person is deemed to have a permanent establishment in each country in which the person is registered or licensed to do business,

(c) where the person uses substantial machinery or equipment at a particular place at any time in a taxation year, the person shall be deemed to have a permanent establishment at that place,

(d) the fact that the person has business dealings through a commission agent, broker or other independent agent or maintains an office solely for the purchase of merchandise shall not of itself be held to mean that the person has a permanent establishment, and

(e) where the person is a corporation, the fact that the person has a subsidiary controlled corporation at a place or a subsidiary controlled corporation engaged in trade or business at a place shall not of itself be held to mean that the person is operating a permanent establishment at that place,

except that, where the person is resident in a country with which the Government of Canada has concluded a tax treaty in which the expression permanent establishment is given a particular meaning, that meaning shall apply.

Treaty Relief

* Article V of the US-Can Tax Treaty provides additional detail for a “permanent establishment” – “a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on”:

**Article 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 an installation or 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 three 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. Notwithstanding the provisions of paragraphs 1, 2, 5 and 9, 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 paragraph 3, where an enterprise of a Contracting State provides services in the other Contracting State, if that enterprise is found not to have a permanent establishment in that other State by virtue of the preceding paragraphs of this Article, that enterprise shall be deemed to provide those services through a permanent establishment in that other State if and only if:

(a) those services are performed in that other State by an individual who is present in that other State for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in that other State by that individual; or

(b) the services are provided in that other State for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of that other State or who maintain a permanent establishment in that other State and the services are provided in respect of that permanent establishment.

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

* + Article V(9) is the services permanent establishment provision:
    - Non-resident must be in the state for at least 183 days, and during that time, more than **50%** of the business’ gross active business revenues comes from said business.

The Test for Permanent Establishment – Permanency and Control

***Sudden Valley Inc v The Queen*** ([FCA 1976](https://nextcanada.westlaw.com/Document/I10b717d0952463f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – No Business Activity in the US

* Facts:
  + Sudden Valley sells recreational property in Washington.
    - Markets the properties through agents and venues in Vancouver.
    - No license to sell real estate property in Canada.
      * Advertisements invited Canadian clients to visit Sudden Valley and perhaps buy properties.
    - Accepts as payment for the properties cash or promissory notes, indexed with interest.
  + Interest earned on promissory notes paid, and thus the treaty imposes a withholding tax.
    - Sudden Valley argued they were carrying on business in Canada, and as such the withholding tax should not have applied.
* Holdings:
  + FCA cited and affirmed the FCTD’s holdings:

... From a glance at the evidence in this case, which I have summarized above, it is abundantly clear that no offer was obtained and no attempt was made to obtain any in Canada and it is equally clear that nothing was offered for sale in Canada either through an agent or otherwise. One must therefore conclude that the real estate business of the plaintiff was not being carried on in Canada even within the extended meaning given to that term by paragraph 253(b).

The only activity carried on in Canada by the plaintiff was that of attempting to induce Canadians to visit Sudden Valley in the hope that some might eventually become interested in buying property there.

* + Solicitation of an order does not include an invitation to treat.
    - “Why don’t you come down and make me an offer” – invitation to treat.
    - “Why don’t you buy this property for $1,000,000” – offer.
  + Advertisement clearly indicated not a sale of property, but only an invitation to treat, as Sudden Valley had no offer to sell.
  + An offer must be capable of acceptance.
* Interest was paid by a Canadian to a non-resident, and was thus subject to Part XIII withholding tax.
  + Had Sudden Valley been carrying on business in Canada through a permanent establishment, then the lower Part I rates would apply (see further *infra*).

***Fowler v Minister of National Revenue*** ([TCC 1990](https://nextcanada.westlaw.com/Document/I10b717cf77bc63f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – A Questionable Interpretation of “Permanent Establishment”

* Facts:
  + Fowler was a resident of the US with a collapsible mobile trailer as his office.
    - He sells knives, car mitts, and kitchen devices at the Vancouver PNE and two other fairs in California.
    - For approximately two weeks a year, Fowler sells products in Vancouver.
  + Fowler argued he was not taxable in Canada because he was not carrying out business in Canada through a permanent establishment.
    - A permanent establishment is a fixed place of business.
  + The CRA argues that the mobile nature of Fowler’s mobile trailer did not change the fact that he came to the same place and at the same time every year to carry out business.
    - Therefore, a permanent establishment is established.
* Holdings:
  + Is a business being made out?
    - Clearly a business – “manufacture … or undertaking of any kind whatsoever” (s. 248 definition).
    - Obviously carried out in Canada – location, inventory, and transactions were all in Canada.
    - But what about a permanent establishment?
  + TCC held that the mobile trailer was a permanent establishment:

In my view the situation, taken in its entirety, supports the conclusion that the appellant had indeed been properly assessed. The following factors were, in my view, determinative of the issue.

The appellant attended the Vancouver PNE annually throughout the preceding 15 years, and his inventory sales occurred on site. Inferentially, the income from the Canadian venture amounted to a significant proportion of the business enterprise as a whole … Obviously the lower the Canadian percentage the higher the overall earnings which he could not justify. Conversely, the higher the Canadian percentage, the less likely the subject venture could be regarded as merely incidental and insignificant.

Conceptually the Vancouver sales were actually being conducted at, or from, a place of business having the same attributes as that of a "place of management", as a "branch" of the whole operation, or as an "office". The matters of mobility and the three-week time period are not in themselves overly material when taken into context. Indeed, it was the very nature of the business itself that mandated these aspects.

* + The TCC’s focus on the “very nature of the business” is mirrored in the OECD Commentary, which notes an exception for permanent establishments for a “business [which] may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger”.
    - Subject to potential change.
  + Is this not questionable because the establishment is only permanent for three weeks?
    - Fowler has never been followed.

***Toronto Blue Jays Baseball Club v Ontario (Minister of Finance)*** ([ONCA 2005](https://nextcanada.westlaw.com/Link/Document/FullText?findType=Y&pubNum=5460&serNum=2006173211&originationContext=document&transitionType=DocumentItem&contextData=(sc.Default))) – Test for Permanent Establishment: Permanence and Legal Control

* Facts:
  + An Ontario health tax case, but which dealt with permanent establishments.
  + The Blue Jays play half of their games outside of Ontario.
    - The Ontario legislation imposes a health tax on any permanent establishment.
    - Argued locker rooms outside of Ontario were also permanent establishments, and as such were not subject to Ontario health taxes.
* Holdings:
  + A permanent establishment must be a fixed place, and must be owned by the employer, likely in the sense that that the employer has a right to use it.
    - Authority over an establishment is different from ownership at law.
  + Test for permanent establishment requires an element of permanency and of legal control:

… Interpreting these words, apart from the provisions of s. 411(1)(c) of the Regulations, my opinion is that the word establishment contemplates a fixed place of business of the corporation, a local habitation of its own. The word "permanent" means that the establishment is a stable one, and not of a temporary or tentative character.

… it is insufficient for given offices to be used for the employer's business. Rather, in Bernier J.A.'s view, there is a requirement that the establishment belong to the employer. This involves an element of ownership, management and authority over the establishment …

Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature.

… The factors to be taken into account would include the actual use made of the premises that are alleged to be his fixed base, whether and by what legal right the person exercised or could exercise control over the premises, and the degree to which the premises were objectively identified with the person's business. This is not intended to be an exhaustive list that would apply to all cases, but it is sufficient for this case. [Dudney]

* + Held on the facts that the use of away game venues did not satisfy either element:

… I am of the opinion that the away venues do not have the characteristics of "a place of management", or a "branch of the whole operation", or as an "office" as was found to be the situation in Fowler. Furthermore, the use of the out-of-town venues of the Teams do not have the element of ownership, management and authority over the establishment as in Syntex Ltd.

I am in agreement with the appellant's submissions that the Teams connections with non-Ontario venues and the control of these venues is relatively so transitory that they cannot be considered to be fixed places of business.

* Perhaps the most important factor that militated against a finding of permanent establishment is the short period of time in which the Blue Jays used the venues – four to six weeks a year.
  + But see Fowler (which has never been followed) for the opposite holding.

***Dudney v R*** ([FCA 2000](https://nextcanada.westlaw.com/Document/I10b717ce5e5163f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Active Business Income from Independent Personal Services; Re-Affirmation of Permanence/Control Test for Permanent Establishment

* Facts:
  + Dudney is a Canadian resident who works under a contract with a Canadian corporation in Canada, which either he or OSG may terminate on 30 days notice.
    - Dudney had access to office space which he had no independent access to, and which could change.
    - Dudney argued the office space was not a permanent establishment.
    - Ability to terminate contract is a counter-point towards permanency, as does the fact that Dudney was moved around.
* Holdings:
  + Was there a “fixed base regularly available to [Dudney]”?
    - Phrase is not defined in the Tax Treaty or the ITA.
    - Under the Vienna Convention, words are examined in their plain and ordinary meaning, in the context of where they were said, and the purpose of the provision and the surrounding provisions for the intent, object, and spirit of the provision.

The term "fixed base regularly available to him" is not defined in the Convention or in the Income Tax Act. The application of Article XIV must therefore be determined on a case by case basis, giving effect to the intention of the contracting states. A literal or legalistic interpretation that might defeat their intention is to be avoided:

* + Case law suggests a fixed place is a permanent place with fixed control, although not the same as a permanent establishment.
    - Court in Dudney determined that the concepts of a “fixed base regularly available” and a “permanent establishment” are essentially the same, and carry similar requirements.
  + From the commentaries, the following definition of a “permanent establishment” may result – “fixed place of business” and an identifiable location with some degree of permanence:

These commentaries indicate that an enterprise has a "permanent establishment" where it has a "fixed place of business," an identifiable location with a certain degree of permanence in which the business of the enterprise is being carried on. By analogy, a particular location is a "fixed base regularly available" to a person who provides independent personal services only if the business of that person is being carried on there.

* + Found no fixed base, no control, no access to property after hours, no signage, no telephone, no business card, was told where to be, what to do, what not to do – all of which suggest no permanent establishment.
  + Court found in particular that Dudney’s lack of control over access to the provided office space precluded the possibility of permanent establishment; together with Toronto Blue Jays, this stresses the need for control.

Case Law – Application of Treaty Relief to Entertainer/Athlete Business Income

***Cheek v The Queen*** ([TCC 2002](https://nextcanada.westlaw.com/Document/I10b717d3ced463f0e0440003ba0d6c6d/View/FullText.html?navigationPath=Search%2Fv3%2Fsearch%2Fresults%2Fnavigation%2Fi0ad62d2e00000168cb37bb4bfcb58a83%3FNav%3DMULTIPLECITATIONS%26fragmentIdentifier%3DI10b717d3ced463f0e0440003ba0d6c6d%26startIndex%3D1%26contextData%3D%2528sc.Search%2529%26transitionType%3DUniqueDocItem&listSource=Search&listPageSource=b182c7cab6f987a1a905fb927acfc3c5&list=MULTIPLECITATIONS&rank=0&sessionScopeId=9382f6c87a2f613bd1f5dc321a15e556c6faba5fb3199ad49fe57ffd25f3ccd8&originationContext=NonUniqueFindSelected&transitionType=UniqueDocItem&contextData=%28sc.Search%29)) – Interpretation of Meaning of “Artiste and Athlete” under Article XVI

* Facts:
  + Cheek was a play-by-play announcer for the Blue Jays.
    - Hired by a radio station as an independent contractor.
    - For the 1996 and 1997 taxation years, he did not have a fixed base or permanent establishment in Canada, and claimed he was not carrying out business through a permanent establishment.
  + The CRA applied Article XVI of the Can-US Tax Treaty to characterize Cheek as an “artiste or athlete”.
    - Activities must be more than $15,000; if not, only taxed in country in residence.
    - If income accrues to benefit of another, that income is deemed to not accrue if that other person played no role in the business.
  + Cheek argued Article VII – the business profits exception – and the CRA argued Article XVI – Cheek was an artist or entertainer.
* Holdings:
  + Cheek was only reporting and commenting, and was not an “artiste”:

I think of the Appellant as primarily a reporter. He is reporting live on radio what is happening in a baseball game. He cannot himself change or cause anyone else to change what happens on the field. Only the players can determine what happens on the field …

Having regard to the dictionary definitions of "artiste", a radio artiste is a person who by some skillful and creative performance (for example, singing or acting or interviewing third parties) can attract an audience to hear that person herself or himself. In the golden age of radio (i.e. before television), Jack Benny, Fred Allen, Bing Crosby and Ma Perkins were radio artistes. In recent times, Peter Gzowski was a radio artiste because he used extraordinary interview skills to draw out individuals (public persons and very private persons) in a way which made their individual endeavours interesting to people all across Canada. Radio audiences listened to people like Jack Benny, Bing Crosby and Peter Gzowski just to hear them perform; not to hear them describe how someone else was performing. The persons drafting the Convention had some purpose in using the word "artiste" by preference over any other word, and in connection with words like "theatre", "motion picture", "radio" and "television", each of which can be a medium for the performing arts.

* + Cheek could not be considered as an artiste, and thus Article XVI does not apply:

… The Appellant regards himself as a sports broadcast journalist. There is no perfect analogy but, if I think in terms of newspaper journalism, the Appellant is like a combined reporter and columnist with respect to Mr. Hedrick's first two basic skills … the Appellant draws on his knowledge, experience and daily contact with players and managers to fill the "down time" when there is no motion on the field. I see the Appellant as a journalist and not as a performing artist.

… The Appellant is not performing as an athlete or sportsman when he comes to Canada to broadcast on radio the Blue Jays home games. It is obvious that athletes and sportsmen "perform" in their chosen athletic avocation; and their performance is inherently entertaining. The baseball fan who turns on the radio to hear a particular Blue Jays game wants to know how the Blue Jays athletes are performing on the field. The Appellant may be able to hold the attention and interest of the fan with his "down time" commentary but he is not the reason why the fan turns on the radio.

The Appellant is not a radio artiste. He is a very skillful and experienced radio journalist. The appeals are allowed, with costs.

***Sumner v The Queen*** ([TCC 1999](https://nextcanada.westlaw.com/Document/I10b717d2b38663f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Apportionment Methods for Business Income; Article VII & XVI Treaty Relief

* Facts:
  + Three countries: Canada, Netherlands, and the US.
    - WyneCo is resident in the Netherlands, and owns 100% of the shares of RMI Corp, resident in the US.
    - Sumner, a Dutch artist, is employed by WyneCo – sole owner of WyneCo is unrelated to Sumner.
  + Sumner carries out a concert tour of 240 days in the North America, 6 days of which were in Canada and the rest of which was in the US.
    - During the tour, Sumner is “loaned” to RMI, a Delaware corporation.
      * Under that agreement, RMI manages the tour, and 95% of the RMI profit is paid to Sumner.
    - $1,488,000 USD is paid to Sumner by RMI in salary.
  + Sumner reports $42,780 CAD, with the remaining balance reported in the US.
    - Calculated by multiplying 6/240 days against the $1.488 million salary and the 1.15 exchange rate.
  + RMI files a **branch return** in Canada – it was a US corporation with a branch in the US and one in Canada.
    - No separate entity for the Canadian operation, thus requiring RMI to file the branch return – a Canadian tax return which reports the Canadian share of revenue and expenses.
    - RMI reports in the US a gross revenue of $5.966 million USD, less the $543,000 USD earned in Canada: **$5.423 million USD (90.89% of the total)**.
      * RMI also reports expenses of ~$600,000 USD, and a loss which it reports in Canada.
  + Minister of National Revenue reassesses the 6/240 day fraction.
    - Recall Austin, *supra*, which used a “games played” approach to apportion income.
      * Sumner essentially took the approach which the CRA applied against Austin.
    - The CRA adopted a gross revenue approach – apportion based on how much gross revenue was earned in Canada and how much was earned in the US.
* Holdings:
  + Application of the “games played”/time spent approach and the comparison to Austin is not fully accurate.
    - Great amount of expense for putting on Canadian concerts.
  + Gross revenue, while not perfect, is closer to how Sumner earned his money than time spent is.

I might observe at the outset that 6/240 is a little suspect because it became clear from the cross-examination of Mr. Kornreich that the denominator of 240 days included an unspecified number of days that had nothing to do with the North American tour.

Quite apart from that it has not been established that the "time" method is any more accurate than the "gross receipts" method. Neither Article XVI of the Canada-U.K. Income Tax Convention nor paragraph 115(1)(a)(ii) of the Income Tax Act provide any guidance. Subsection 4(1) of the Act requires a factual determination or allocation between sources of income in different places but apart from requiring an assumption that income from a particular location is the only income and a reasonable allocation of expenses, it provides no rules.

* + If the two methods were equally valid, then the taxpayer’s method of apportionment prevails.
  + If, on a balance of probabilities, one can establish one method is superior to the other, then that method prevails.
  + However, as a second issue, Sumner argued that Article VII(1) of the US-Can Tax Treaty was applicable:

**Article VII**

**Business Profits**

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.

* + - RMI, a US resident, should only be taxable in Canada if they operated through a permanent establishment, which the facts indicated they did not have.
      * Due to the lack of permanent establishment, if Article VII was the only issue, RMI would not be taxable.
  + However, Article XVI (Artistes and Athletes) is paramount (due to use of “notwithstanding”) to Article VII.
    - Article XVI(1) is applicable as Sumner earned more than $15,000, more than the treaty relief amount.
    - Article XVI(2) is applicable as income from Sumner’s personal expenses accrue in another person.
      * RMI reported 100% of tour revenues, minus expenses, before making payments to Sumner.
      * Would not matter if Sumner received part of the gross (e.g. 7%), along with his 95% share of the net income resulting from the remaining part of the gross (e.g. 93%) paid to RMI; the wording of Article XVI(2) does not require that “all income” accrues in another person.
  + Who is actually taxed on the accrued income though?
    - Court held that both the entertainer and corporation could be taxed.
      * Article XVI(2)’s language seems to suggest only the income accrued to the other person should be taxed – particularly, the use of “that income” following description of the accrual.
      * “Where some or all of income … accrues to another person, that amount, so accruing to another person, may be taxed in the Contracting State in which the activities are exercised” would be more clear to stress that only the accrued party can be taxed.

C: Withholdings for Business Carried on in Canada

Withholdings Under the Regulations

Regulation 102 Withholding

* Section 153 addresses payment of tax:

**Withholding**

**153(1)** Every person paying at any time in a taxation year

(a) salary, wages or other remuneration, other than

(i) amounts described in subsection 212(5.1), and

(ii) amounts paid at any time by an employer to an employee if, at that time, the employer is a qualifying non-resident employer and the employee is a qualifying non-resident employee,

…

[Various benefits]

…

shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee’s tax for the year under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution.

* + Essentially requires remittance of salary, remuneration, and other benefits to the Receiver General.
    - Requires various source deductions by the employer for the employee: CPP, EI, and income tax.
    - Section 153(1) requires the same to be done for non-residents in accordance to the “prescribed rules”.
      * “Prescribed rules” refers to matters detailed in the Regulations to the ITA.
* Regulation 102 is the pertinent regulation – this can be readily identified in the annotations under each section.
  + With any other statute, one needs to navigate through every provision in the Regulations, as Regulations are not organized in any logical format.
  + Requires calculation under a formula, and then withholding on salary, remuneration, and other benefits.

Regulation 105 Withholding

* Section 153 of the ITA provides for withholdings.
  + Section 153(1)(g) requires the following withholdings:

**Withholding**

**153 (1)** Every person paying at any time in a taxation year

…

(g) fees, commissions or other amounts for services, other than amounts described in subsection 115(2.3) or 212(5.1)

…

shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee’s tax for the year under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution.

* + “Fees, commissions or other amounts” is incredibly broad wording.
  + The person paying the fee is required to remit – “every person paying”, not “every person receiving”.
* Contrast wording against those in s. 105 of the Regulations:

**Non-Residents**

**105(1)** Every person paying to a non-resident person a fee, commission or other amount in respect of services rendered in Canada, of any nature whatever, shall deduct or withhold 15 per cent of such payment.

(2) Subsection (1) does not apply to a payment

(a) described in the definition remuneration in subsection 100(1);

(b) made to a registered non-resident insurer (within the meaning assigned by section 804); or

(c) made to an authorized foreign bank in respect of its Canadian banking business.

* + Requires that the resident payor withhold 15% of any payment for a fee, commission, or other amount to a non-resident, and then to remit those amounts to the Receiver General.
* Section 227(1) provides a liability shield for a resident payor fulfilling their withholdings:

**Withholding taxes**

**227(1)** No action lies against any person for deducting or withholding any sum of money in compliance or intended compliance with this Act.

* Section 227(8) & 226(8.1) reinforce collection responsibilities by allowing for penalties where withholdings not done.

**Penalty**

**227(8)** Subject to subsection (9.5), every person who in a calendar year has failed to deduct or withhold any amount as required by subsection 153(1) or section 215 is liable to a penalty of

(a) 10% of the amount that should have been deducted or withheld; or

(b) where at the time of the failure a penalty under this subsection was payable by the person in respect of an amount that should have been deducted or withheld during the year and the failure was made knowingly or under circumstances amounting to gross negligence, 20% of that amount.

**Joint and several, or solidary, liability**

**227(8.1)** If a particular person has failed to deduct or withhold an amount as required under subsection 153(1) or section 215 in respect of an amount that has been paid to a non-resident person, the non-resident person is jointly and severally, or solidarily, liable with the particular person to pay any interest payable by the particular person pursuant to subsection (8.3) in respect thereof.

* + Section 227(8) allows for substantial penalties to be imposed when payee fails to withhold.
  + Both the resident and non-resident are responsible for withholding tax: s. 227(8.1) joint and several liability.
* Section 227(8.3) concerns interest for outstanding withholding amounts.

**Interest on amounts not deducted or withheld**

**227(8.3)** A person who fails to deduct or withhold any amount as required by subsection 135(3), 135.1(7), 153(1) or 211.8(2) or section 215 shall pay to the Receiver General interest on the amount at the prescribed rate, computed [accordingly]…

* Section 227(8.4) allows for a right of set-off, which under contract law, must be specifically afforded.

**Liability to pay amount not deducted or withheld**

**(8.4)** A person who fails to deduct or withhold any amount as required under subsection 135(3) or 135.1(7) in respect of a payment made to another person or under subsection 153(1) in respect of an amount paid to another person who is non-resident or who is resident in Canada solely because of paragraph 250(1)(a) is liable to pay as tax under this Act on behalf of the other person the whole of the amount that should have been so deducted or withheld and is entitled to deduct or withhold from any amount paid or credited by the person to the other person or otherwise to recover from the other person any amount paid by the person as tax under this Part on behalf of the other person.

* + Allows for the proper withholdings to be withheld by setting off other debts and amounts owing between the parties to complete the balance.
* Section 227.1 provides for director’s liability.

**Liability of directors for failure to deduct**

**227.1(1)** Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

* Right of set-off, interest, penalties, and director’s liability all indicate how seriously the CRA administers withholdings.

***Ogden Palladium Services (Canada) Inc v R*** ([TCC 2001](https://nextcanada.westlaw.com/Document/I10b717d2e9b963f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Regulation 105 Withholdings Always Necessary for Services Provided; Treaty Relief

* Facts:
  + Ogden Palladium Services (OPS) is an arena manager, and operates an arena in Ontario.
  + Marco Entertainment is a US company which manages a skating production.
    - Marco receives from OPS a license to use the facility, for which Marco pays a fee.
  + The two contract to have OPS do all administrative tasks – workers, programmes, ticket sales, etc – for a fee.
  + OPS then provides ticket revenue to Marco.
  + Marco applied for a waiver for Regulation 105 withholding, arguing that Marco had no permanent establishment in Canada, and thus should not have been taxed.
    - Minister denied on the basis that Marco had a permanent establishment.
      * Could argue that Marco retained OPS, who did have a permanent establishment.
      * Could also argue that Marco exercised control through a license.
  + Ticket sales of $10,000, admin costs of $3,000, and license fees of $1,000 – net payments to Marco of $6,000.
    - Minister assessed for Regulation 105, as services were performed in Canada to a non-resident.
* Holdings:
  + Contrary to the CRA’s assertions, it was uncertain whether Marco had a permanent establishment in Canada.
  + Marco provided a service, and applied for a waiver, but was denied the waiver:

In my opinion, a producer of a show can be viewed as rendering services. Indeed, the producer can be defined as the one who administers and supervises the making of the show that will be presented to the public. He is part of the process by which the show can be brought about (this meets the definition of "services" given in the Taylor case, supra). In my view, the producer is providing assistance in presenting the show for the benefit of another (the public).

…

The Court seems to have relied on the fact that the ticket holder did not contract directly with the performers and had no direction or control over when or how the services were to be performed, and on the fact that the services would be performed whether or not the ticket holder exercised his or her right to attend the theatre and to occupy a seat at the performance. The Court is not saying that the producer was not providing services. It is saying that what the ticket holder was purchasing was not the services provided but rather a right to attend a theatre for a particular performance.

… this interpretation … does not alter the fact that the producer is providing services for the benefit of the public as a whole. Indeed, the public would not buy tickets if no services were provided …

In any event, it was recognized at least that the performers were providing services and in the present case those entertainment services were undoubtedly rendered in Canada. It is obvious in my view that the payment to Marco was in respect of services performed in Canada. If the performers had not performed services in Canada, no tickets would have been sold and no money would have been remitted to Marco.

In the circumstances, I am of the view that the appellants made payments to Marco for or in respect of services rendered in Canada. Accordingly, the appellants had an obligation to withhold the proper amounts pursuant to paragraph 153(1)(g) of the Act and section 105 of the Regulations.

* + - Consequently, OPS is required to withhold monies under Regulation 105 for payments for a service provided by a non-resident.
      * Does not require that the recipient of the payment is the provider of the services, or that the services were rendered to the person making the payment; Regulation 105 requires withholdings whenever there is a payment made for services rendered in Canada.
        + Here, the non-resident service provider is Marco by producing skating shows.
        + The service recipient is the public attendants to those shows.
        + The resident payee is OPS, who although are not the service recipient, are required to withhold nonetheless.
  + The performers are non-residents employed by Marco, and performing services in Canada.
    - Does not matter if the employer was resident or non-resident; so long as there are non-residents performing services for an employer in Canada, the employer must withhold tax under Regulation 102.
      * Was not at issue in the case, but still important to consider.
  + Regulation 105 applies even if the non-resident payee is unprofitable in Canada.
  + Regulation 105 applies even if the non-resident payee is non-taxable in Canada.
* Does the treaty assist?
  + Article XV(1) allows for Canada to tax the work done in Canada by non-residents.
  + Article XV(2) only provides relief from this Canadian tax if the remuneration does not exceed $10,000.
    - Likely applies for the administrative workers, and Canada is not entitled to tax those US residents.
  + Article XVI(2) applies on the first sentence, but does not apply on the second.
    - On the first sentence, income does funnel through to another person, but due to the second sentence, the skaters presumably do not “participate” (i.e. share) in the profits of the accruing party.
    - Does not provide relief.

***Weyerhaeuser Co v R*** ([TCC 2007](https://nextcanada.westlaw.com/Document/I28f084e837c65d0fe0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Regulation 105 Withholdings Limited to Services Provided in Canada

* Facts:
  + Weyerhaeuser Co was successor corporation following amalgamation with MB Ltd.
  + MB Ltd, a Canadian corporation, paid a fee for services rendered by a US corporation in Canada, and paid Regulation 105 withholding fees.
    - Did not withhold for services and airfare outside of Canada.
    - Relied on invoices provided to them by the US corporation.
    - Withheld in total $1.5 million.
  + The CRA argues MB Ltd should have withheld $2.1 million.
  + MB Ltd accepts certain amounts and disputes other amounts.
* Three issues before the Court:
  + Is Regulation 105 ultra vires or intra vires?
  + Is Regulation 105 required in respect of disbursements for services provided outside of Canada?
  + What is the evidentiary burden?
* Holdings:
  + Court held that Regulation 105 was intra vires.
  + However, Regulation 105 only requires withholdings for payments and commissions with respect to services; no withholding necessary for expenses and reimbursements for travel or otherwise.
    - Withholdings cannot expand beyond services.
    - No withholdings necessary for management fees earned while in US.
  + Evidence put forward to establish which services were conducted in Canada and outside Canada, while questionable, was sufficient to meet the necessary burden of proof:

Just like all the other attributions in all the other invoices, one may speculate as to the accuracy of this estimate; however, the fact remains that it is an invoice submitted and paid in the ordinary course of commerce, and so it has evidentiary value, and there being neither a valid contrary assumption that the appellant must rebut nor contradictory evidence, it is sufficient to satisfy the appellant's burden of showing that the assessment is, so far as it relates to this item, ill-founded.

Branch Tax

Purpose and Calculation of the Branch Tax

* Say a Canadian corporation pays a dividend to a non-resident parent corporation.
  + The Canadian subsidiary pays Part I tax on its Canadian profits.
  + A **Part XIII withholding tax** applies, of either **5%,** **15**%, or **25%,** depending on the circumstances.
    - Treaty notes a 5% rate for a foreign corporation which holds more than 10% of the shares, and 15% for all other dividends.
* Say a US corporation is carrying on business in Canada.
  + The US Corp must pay Part I tax on its Canadian profits.
    - $10,000 subject to 27% corporate tax rates, leaving the US Corp with $7,300.
  + The US Corp must also calculate the change in its net assets.
    - Say at open, its net assets are worth $100,000; if at close, its net assets are worth $99,000, then $1,000 will be subject to a **branch tax** on that amount under **Part XIV**.
      * If a treaty corporation, the treaty rate applies – **5%** with the US (s. 219.2; Art X(6)).
      * If not a treaty corporation, the default **25%** withholding tax applies (s. 219).
      * The assumption is that the US Corp brought $1,000 from its branch back to the US.
        + This amount is taxed at a 5% rate.
* Returning to the above corporate example, say the CanCo earns net income of $10,000.
  + It pays Part I tax on that amount of $2,700 and is left with $7,300.
  + The CanCo then pays out $1,000 as a dividend to USCo, with a withholding tax of 5% or $50.
* Branch tax is meant to model the withdrawal of assets from a branch to the parent corporation in a way that is similar to the payment of a dividend from a foreign subsidiary to its parent.
  + Aim is to reach the same tax consequences whether a foreign corporation is operating through a separate subsidiary entity or a branch tax.
  + No branch tax if there is an increase in the value of net assets over the year; branch tax only applies if there is a reduction in net assets.
* Section 219 establishes the branch tax.

**Additional tax**

**219(1)** Every corporation that is non-resident in a taxation year shall, on or before its balance-due day for the year, pay a tax under this Part for the year equal to 25% of the amount, if any, by which the total of

(a) the corporation’s taxable income earned in Canada for the year (in this subsection referred to as the corporation’s “base amount”),

(b) the amount deducted because of section 112 and paragraph 115(1)(e) in computing the corporation’s base amount, [dividends]

* Article X(6) is the treaty reduction of branch tax on branch earnings from 25% to **5%.**
  + Furthermore, under Article X(6)(d), the first **$500,000** is exempt from branch tax (essentially first **$25,000** of branch tax payable).

**Article X**

**Dividends**

**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.

D: Active Income Earned by Non-Residents – Dispositions of Property

Disposition of Taxable Canadian Property

Relevant ITA Provisions – Definition and Taxation of Taxable Canadian Property

* Section 2(3)(c) clearly indicates that non-residents are taxable on their disposition of taxable Canadian property.

**Tax payable by non-resident persons**

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

…

(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.

* + Real property is certain taxable Canadian property.
    - On the disposition of such property, the amount taxable is equal to proceeds of disposition less cost.
      * Upon such a disposition, the resident is required to withhold certain amounts, per s. 116.
        + In place for policy reasons as to enforcement and collection against non-residents.
      * Withholding is not necessary if the other party is not a non-resident.
  + Real property, inventory in a business, resource property, shares with 50% or more value in those things, and options or interests in those things.
* Section 115(1), as with s. 2(3)(c), also captures disposition of taxable Canadian property as part of a non-resident’s taxable income.

**Non-resident’s taxable income in Canada**

**115(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

(a) the non-resident person had no income other than

…

(iii) taxable capital gains from dispositions described in paragraph 115(1)(b),

…

(b) the only taxable capital gains and allowable capital losses referred to in paragraph 3(b) were taxable capital gains and allowable capital losses from dispositions, other than dispositions deemed under subsection 218.3(2), of taxable Canadian properties (other than treaty-protected properties) …

* Section 248(1) provides a definition for “taxable Canadian property”.

***taxable Canadian property*** of a taxpayer at any time in a taxation year means a property of the taxpayer that is

(a) real or immovable property situated in Canada,

(b) property used or held by the taxpayer in, property included in Class 14.1 of Schedule II to the Income Tax Regulations in respect of, or property described in an inventory of, a business carried on in Canada, other than

(i) property used in carrying on an insurance business, and

(ii) where the taxpayer is non-resident, ships and aircraft used principally in international traffic and personal or movable property pertaining to their operation if the country in which the taxpayer is resident does not impose tax on gains of persons resident in Canada from dispositions of such property,

…

(d) a share of the capital stock of a corporation (other than a mutual fund corporation) that is not listed on a designated stock exchange, an interest in a partnership or an interest in a trust (other than a unit of a mutual fund trust or an income interest in a trust resident in Canada), if, at any particular time during the 60-month period that ends at that time, more than 50% of the fair market value of the share or interest, as the case may be, was derived directly or indirectly … from one or any combination of

(i) real or immovable property situated in Canada,

(ii) Canadian resource properties,

(iii) timber resource properties, and

(iv) options in respect of, or interests in, or for civil law rights in, property described in any of subparagraphs (i) to (iii), whether or not the property exists,

(e) a share of the capital stock of a corporation that is listed on a designated stock exchange, a share of the capital stock of a mutual fund corporation or a unit of a mutual fund trust, if, at any particular time during the 60-month period that ends at that time,

(i) 25% or more of the issued shares of any class of the capital stock of the corporation, or 25% or more of the issued units of the trust, as the case may be, were owned by or belonged to one or any combination of

(A) the taxpayer,

(B) persons with whom the taxpayer did not deal at arm’s length, and

(C) partnerships in which the taxpayer or a person referred to in clause (B) holds a membership interest directly or indirectly through one or more partnerships, **and**

(ii) more than 50% of the fair market value of the share or unit, as the case may be, was derived directly or indirectly from one or any combination of properties described under subparagraphs (d)(i) to (iv), or

(f) an option in respect of, or an interest in, or for civil law a right in, a property described in any of paragraphs (a) to (e), whether or not the property exists,

and, for the purposes of section 2, subsection 107(2.001) and sections 128.1 and 150, and for the purpose of applying paragraphs 85(1)(i) and 97(2)(c) to a disposition by a non-resident person, includes

(g) a Canadian resource property,

(h) a timber resource property,

(i) an income interest in a trust resident in Canada,

(j) a right to a share of the income or loss under an agreement referred to in paragraph 96(1.1)(a), and

(k) a life insurance policy in Canada; (bien canadien imposable)

* + Paragraph (b) of this definition (Class 14.1) relates to goodwill and intangible expenditures.
  + Paragraph (d) concerns shares in a private corporation where more than 50% of the value (at any point in the last 60 months) of those shares derives from the enumerated forms of property.
    - Does not capture public corporations (listed on a designated exchange ((e) applies) or partnerships.
    - Say a resident purchases shares from a non-resident, who represents that at no point in the last 60 months more than 50% of the shares’ value derived from real property. Is that enough?
      * Likely should verify with the balance sheets that these representations are correct.
  + Paragraph (e) captures public corporations if the conjunctive test is satisfied (any time in the last 60 months):
    - The non-resident taxpayer (and non-arm’s length parties and partnerships) own at least 25% of the shares in that corporation; and
      * Non-arm’s length includes anyone immediately related to the taxpayer, and anyone who the taxpayer is factually non-arm’s length with.
    - More than 50% of the value of the shares is derived from real property, resource property, or timber resources.
    - Factual deeming of non-arm’s length has been set out in case law.
      * Unusually low quantum.
      * Terms that are not commercial in scope.
      * There was a common controlling mind.
* Section 248(1) also provides a definition for “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;

* Section 116(1) is complicated and should be considered against several types of property:
  + **Taxable Canadian Property (TCP)**:
    - Real property.
    - Business inventory.
    - Resource property.
    - Shares with 50% or more value in TCP.
  + **Treaty Protected Property (TPP)**:
    - Income or gain exempt due to a treaty.
  + **Excluded Property (EP)**:
    - Deemed TCP.
    - Inventory.
    - Debt obligations.
    - **Treaty Exempt Property**.
  + **Treaty Exempt Property (TEP)**.
    - Where the purchaser and vendor are related, captures TPP where notice is provided under s. 116(5.02).

**Disposition by non-resident person of certain property**

**116(1)** If a non-resident person proposes to dispose of any taxable Canadian property (other than property described in subsection (5.2) and excluded property) the non-resident person may, at any time before the disposition, send to the Minister a notice setting out

(a) the name and address of the person to whom he proposes to dispose of the property (in this section referred to as the “proposed purchaser”);

(b) a description of the property sufficient to identify it;

(c) the estimated amount of the proceeds of disposition to be received by the non-resident person for the property; and

(d) the amount of the adjusted cost base to the non-resident person of the property at the time of the sending of the notice.

* + Formerly referred to as a “clearance certificates” and now as “compliance certificates”.
    - Once a purchaser requests one of these certificates, they are entitled to rely upon that certificate for the withholding requirements.
  + The use of the word “proposes” is key.
  + “Property described in (5.2)” is property to which a compliance certificate has already been acquired (i.e. that the property has already been subject to this process).

**Definition of excluded property**

**116(6)** For the purposes of this section, excluded property of a non-resident person means

(a) a property that is a taxable Canadian property solely because a provision of this Act deems it to be a taxable Canadian property;

(a.1) a property (other than real or immovable property situated in Canada, a Canadian resource property or a timber resource property) that is described in an inventory of a business carried on in Canada by the person;

(b) a security that is

(i) listed on a recognized stock exchange, and

(ii) either

(A) a share of the capital stock of a corporation, or

(B) SIFT wind-up entity equity;

(c) a unit of a mutual fund trust;

(d) a bond, debenture, bill, note, mortgage, hypothecary claim or similar obligation;

(e) property of a non-resident insurer that

(i) is licensed or otherwise authorized under the laws of Canada or a province to carry on an insurance business in Canada, and

(ii) carries on an insurance business, within the meaning of subsection 138(1) of the Act, in Canada;

(f) property of an authorized foreign bank that carries on a Canadian banking business;

(g) an option in respect of property referred to in any of paragraphs (a) to (f) whether or not such property is in existence;

(h) an interest, or for civil law a right, in property referred to in any of paragraphs (a) to (g); and

(i) a property that is, at the time of its disposition, a treaty-exempt property of the person.

* + Paragraph (a) captures property that was rolled over or purchased using TCP.
    - E.g. Land that was swapped out for shares.
* Section 116(6.1) defines “treaty-exempt property”.

**Treaty-exempt property**

**116(6.1)** For the purpose of subsection (6), a property is a treaty-exempt property of a non-resident person, at the time of the non-resident person’s disposition of the property to another person (referred to in this subsection as the “purchaser”), if

(a) it is, at that time, a treaty-protected property of the non-resident person; and

(b) where the purchaser and the non-resident person are related at that time, the purchaser provides notice under subsection (5.02) in respect of the disposition.

Relevant ITA Provisions – Compliance Certificates

* Section 116(2) deals with certificates for a proposed disposition of taxable Canadian property, following the notice under s. 116(1).

**Certificate in respect of proposed disposition**

**116(2)** Where a non-resident person who has sent to the Minister a notice under subsection 116(1) in respect of a proposed disposition of any property has

(a) paid to the Receiver General, as or on account of tax under this Part payable by the non-resident person for the year, 25% of the amount, if any, by which the estimated amount set out in the notice in accordance with paragraph 116(1)(c) exceeds the amount set out in the notice in accordance with paragraph 116(1)(d), or

(b) furnished the Minister with security acceptable to the Minister in respect of the proposed disposition of the property,

the Minister shall forthwith issue to the non-resident person and the proposed purchaser a certificate in prescribed form in respect of the proposed disposition, fixing therein an amount (in this section referred to as the “certificate limit”) equal to the estimated amount set out in the notice in accordance with paragraph 116(1)(c).

* + If one is selling property, and the property has not already been approved and is not excluded property, then the taxpayer sends a notice to the Minister noting the ACB in the property and the likely proceeds.
    - Along with this, there must be included withholdings equal to **25%** of the difference between the likely proceeds and the ACB (s. 116(2)(a)).
  + If the notice is done in accordance to this provision, then the Minister will issue a compliance certificate.
* Sections 116(3) & 116(4) detail notice and certificates upon actual disposition of property.

**Notice to Minister**

**116(3)** Every non-resident person who in a taxation year disposes of any taxable Canadian property of that person (other than property described in subsection 116(5.2) and excluded property) shall, not later than 10 days after the disposition, send to the Minister, by registered mail, a notice setting out

(a) the name and address of the person to whom the non-resident person disposed of the property (in this section referred to as the “purchaser”),

(b) a description of the property sufficient to identify it, and

(c) a statement of the proceeds of disposition of the property and the amount of its adjusted cost base to the non-resident person immediately before the disposition,

unless the non-resident person has, at any time before the disposition, sent to the Minister a notice under subsection 116(1) in respect of any proposed disposition of that property and

(d) the purchaser was the proposed purchaser referred to in that notice,

(e) the estimated amount set out in that notice in accordance with paragraph 116(1)(c) is equal to or greater than the proceeds of disposition of the property, and

(f) the amount set out in that notice in accordance with paragraph 116(1)(d) does not exceed the adjusted cost base to the non-resident person of the property immediately before the disposition.

**Certificate in respect of property disposed of**

**116(4)** Where a non-resident person who has sent to the Minister a notice under subsection 116(3) in respect of a disposition of any property has

(a) paid to the Receiver General, as or on account of tax under this Part payable by the non-resident person for the year, 25% of the amount, if any, by which the proceeds of disposition of the property exceed the adjusted cost base to the non-resident person of the property immediately before the disposition, or

(b) furnished the Minister with security acceptable to the Minister in respect of the disposition of the property,

the Minister shall forthwith issue to the non-resident person and the purchaser a certificate in prescribed form in respect of the disposition.

* + If one is selling property, and the property has not already been approved and is not excluded property, then the taxpayer sends a notice to the Minister noting the ACB in the property and the likely proceeds.
    - There must also be included withholdings equal to **25%** of the difference between the likely proceeds and the ACB (same conditions as when a non-resident proposes to sell a TCP).
* Section 116(5) concerns liability for the resident purchaser of a non-resident’s TCP.

**Liability of purchaser**

**116(5)** Where in a taxation year a purchaser has acquired from a non-resident person any taxable Canadian property (other than depreciable property or excluded property) of the non-resident person, the purchaser, unless

(a) after reasonable inquiry the purchaser had no reason to believe that the non-resident person was not resident in Canada,

(a.1) subsection (5.01) applies to the acquisition, or

(b) a certificate under subsection 116(4) has been issued to the purchaser by the Minister in respect of the property,

is liable to pay, and shall remit to the Receiver General within 30 days after the end of the month in which the purchaser acquired the property, as tax under this Part for the year on behalf of the non-resident person, 25% of the amount, if any, by which

(c) the cost to the purchaser of the property so acquired

exceeds

(d) the certificate limit fixed by the certificate, if any, issued under subsection 116(2) in respect of the disposition of the property by the non-resident person to the purchaser,

and is entitled to deduct or withhold from any amount paid or credited by the purchaser to the non-resident person or otherwise recover from the non-resident person any amount paid by the purchaser as such a tax.

* + If the conditions under (a) – (b) are not satisfied (i.e. certificates not issued, the property has not been previously approved, or the property is TPP), then the resident purchaser is liable to remit the withholding taxes.
    - Requires reasonable inquiry by the purchaser to confirm one of the exceptions is satisfied before relying upon those to not remit withholding taxes.

Relevant ITA Provisions – Relief from Taxation

* Section 116(5.01) defines **treaty-protected property** and the exception under s. 116(5)(a.1) which removes liability on the resident taxpayer to remit withholding taxes.

**Treaty-protected property**

**116(5.01)** This subsection applies to the acquisition of a property by a person (referred to in this subsection as the “purchaser”) from a non-resident person if

(a) the purchaser concludes after reasonable inquiry that the non-resident person is, under a tax treaty that Canada has with a particular country, resident in the particular country;

(b) the property would be treaty-protected property of the non-resident person if the non-resident person were, under the tax treaty referred to in paragraph (a), resident in the particular country; and

(c) the purchaser provides notice under subsection (5.02) in respect of the acquisition.

* + Section 116(5.01) requires satisfaction of three conjunctive elements to avoid withholdings on TPP.
    - First, as with the conditions under s. 116(5), paragraph (a) only requires that the confirmation that the non-resident is resident in a treaty country only requires a “reasonable inquiry”.
      * Inquiry must only be satisfied on a balance of probabilities.
    - However, paragraph (b) then requires that the purchaser is correct that the property would be TPP.
    - Lastly, paragraph (c) requires the purchaser to provide notice to the Minister, per s. 116(5.02).

**Notice by purchaser in respect of an acquisition of property**

**116(5.02)** A person (referred to in this subsection as the “purchaser”) who acquires property from a non-resident person provides notice under this subsection in respect of the acquisition if the purchaser sends to the Minister, on or before the day that is 30 days after the date of the acquisition, a notice setting out

(a) the date of the acquisition;

(b) the name and address of the non-resident person;

(c) a description of the property sufficient to identify it;

(d) the amount paid or payable, as the case may be, by the purchaser for the property; and

(e) the name of the country with which Canada has concluded a tax treaty under which the property is a treaty-protected property for the purposes of subsection (5.01) or (6.1), as the case may be.

* + If all three conditions are satisfied, the resident is not required to remit taxes under s. 116(5).
* Section 116(5.1) concerns the proceeds of disposition for gifts under this section and thus the determination of the quantum of withholding taxes.

**Gifts, etc.**

**116(5.1)** If a non-resident person has disposed of or proposes to dispose of a life insurance policy in Canada, a Canadian resource property or a taxable Canadian property other than

(a) excluded property, or

(b) property that has been transferred or distributed on or after the non-resident person’s death and as a consequence thereof

to any person by way of gift inter vivos or to a person with whom the non-resident person was not dealing at arm’s length for no proceeds of disposition or for proceeds of disposition less than the fair market value of the property at the time the non-resident person so disposed of it or proposes to dispose of it, as the case may be, the following rules apply:

(c) the reference in paragraph 116(1)(c) to “the proceeds of disposition to be received by the non-resident person for the property” shall be read as a reference to “the fair market value of the property at the time the non-resident person proposes to dispose of it”,

(d) the references in subsections 116(3) and (4) to “the proceeds of disposition of the property” shall be read as references to “the fair market value of the property immediately before the disposition”,

(e) the references in subsection 116(5) to “the cost to the purchaser of the property so acquired” shall be read as references to “the fair market value of the property at the time it was so acquired”, and

(f) the reference in subsection 116(5.3) to “the amount payable by the taxpayer for the property so acquired” shall be read as a reference to “the fair market value of the property at the time it was so acquired”.

* + Except for a gift of excluded property, or a gift upon death, the FMV must be used to determine the proceeds of disposition for the purposes of s. 116.
* Section 116(5.2) applies to both proposed and actual dispositions.

**Certificates for dispositions**

**116(5.2)** If a non-resident person has, in respect of a disposition, or a proposed disposition, in a taxation year to a taxpayer of property (other than excluded property) that is a life insurance policy in Canada, a Canadian resource property, a property (other than capital property) that is real property, or an immovable, situated in Canada, a timber resource property, depreciable property that is a taxable Canadian property or any interest in, or for civil law any right in, or any option in respect of, a property to which this subsection applies (whether or not that property exists),

(a) paid to the Receiver General, as or on account of tax under this Part payable by the non-resident person for the year, such amount as is acceptable to the Minister in respect of the disposition or proposed disposition of the property, or

(b) furnished the Minister with security acceptable to the Minister in respect of the disposition or proposed disposition of the property,

the Minister shall forthwith issue to the non-resident person and to the taxpayer a certificate in prescribed form in respect of the disposition or proposed disposition fixing therein an amount equal to the proceeds of disposition, proposed proceeds of disposition or such other amount as is reasonable in the circumstances.

* + Concerns life insurance, real property (other than capital property), resource property, and depreciable property.
    - Compared to s. 116(1), this includes life insurance, depreciable property, and real property inventory.
* Section 116(5.3) applies liability for the properties described in s. 116(5.2).

**Liability of purchaser in certain cases**

**116(5.3)** Where in a taxation year a taxpayer has acquired from a non-resident person property referred to in subsection 116(5.2),

(a) the taxpayer, unless subsection (5.01) applies to the acquisition or unless after reasonable inquiry the taxpayer had no reason to believe that the non-resident person was not resident in Canada, is liable to pay, as tax under this Part for the year on behalf of the non-resident person, 50% of the amount, if any, by which

(i) the amount payable by the taxpayer for the property so acquired

exceeds

(ii) the amount fixed in the certificate, if any, issued under subsection 116(5.2) in respect of the disposition of the property by the non-resident person to the taxpayer

and is entitled to deduct or withhold from any amount paid or credited by the taxpayer to the non-resident person or to otherwise recover from the non-resident person any amount paid by the taxpayer as such a tax; and

(b) the taxpayer shall, within 30 days after the end of the month in which the taxpayer acquired the property, remit to the Receiver General the tax for which the taxpayer is liable under paragraph 116(5.3)(a).

* + The withholding rate on these properties is **50%**.
    - This is because the properties so concerned are fully included in income, while the properties described in s. 116(1) have a 50% inclusion rate.
* Section 116 is a withholding provision, not a charging one.
  + A charging provision notes that an amount shall be taxed against something.
  + This is a compliance provision – “you will withhold 25% or 50% of the proceeds”.
    - After withholding, the taxpayer then remits the amounts.
    - The taxpayer ultimately files the transaction, reports the gain, and calculates their tax payable using the charging provisions.
      * The taxpayer is thereafter entitled to deduct the withheld amount from their tax payable.
        + The reason that the higher 50% withholding rate exists is because the properties that concerns will attract higher tax payable, so there should be a higher withholding rate.

***RCI Trust (Trustee of) v Minister of National Revenue*** ([FCA 2009](https://nextcanada.westlaw.com/Document/I7b5c29af8d8b2e47e0440003bacbe8c1/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Must Remit Withholdings Even for TPP Compliance Certificates

* Facts:
  + Trust was settled in Barbados.
  + In 2006, the trust disposed of shares in a taxable Canadian corporation to another taxable Canadian corporation – LES Investments – for $145 million.
  + Which s. 116 certificate is necessary 30 days before the transaction?
    - Section 116(1) only applies if s. 116(5.2) does not apply.
      * Section 116(5.2) does not apply: the shares are not any of those enumerated.
      * Section 116(1) therefore applies.
  + What occurs 45 days after the transaction?
    - If there has not been a remittance, then LES Investments will remit and then can collect against RCI Trust for those amounts.
  + RCI Trust attempts to define the property as TPP and believes that on those grounds no certificate is necessary and no withholding tax is necessary.
* Issue was whether the CRA is required to issue a certificate where the property is TPP.
* Holdings:
  + Not necessary when issuing a certificate to determine whether property is TPP.
  + Section 116(2) is clear: the certificate must only be issued where notice has been provided **and** the necessary amounts of tax are paid.
    - It does not require the Minister to determine whether the property was TPP before demanding the withholding taxes.
      * Such a determination is better left to the filing and processing of an income tax return.
    - Section 116 is a statutory device for requiring withholding tax, not a provision which demands that the Minister determine liability for tax on the disposition of capital property (i.e. determine whether a property is TPP).
  + The CRA is not required under any part of s. 116 to determine whether a specific property is TPP, and thereby remove the need for s. 116(1) or s. 116(2) to apply.
    - Therefore, under the legislation, the taxpayer must pay out **25%** of the necessary amounts, remit the funds, apply for a refund due to the property being TPP, and then receive the refund.

Treaty Provisions for Disposition of Taxable Canadian Property

* Article XIII, dealing with Gains, is the relevant provision.

**Article XIII**

**Gains**

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, including such gains from the alienation of such a permanent establishment, 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.

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.

* + Article XIII(3)(b) is similar to s. 116 and the definition of taxable Canadian property and defines “real property situated in the other Contracting state”.
    - E.g. Canadian resident uses $20,000 to purchase shares in a USCo. Two years later the shares are worth $30,000 and the resident sells the shares. Are the shares taxable?
      * Article XIII(1) does not apply as it is not real property.
      * Article XIII(2) does not apply as it is not personalty, and certainly not personalty part of the business.
      * Article XIII(3) does not apply as the shares are not “real property situated in the other Contracting state (i.e. the US)”.
      * Article XIII(4) therefore allows only Canada to tax the gains.

E: Passive Income Derived from Sources in Canada by Non-Residents

General Principles of Part XIII Tax

Relevant ITA Provisions

* Section 212 applies where a Canadian resident payor pays a non-resident payee, and imposes a deemed tax – **Part XIII tax** – on the non-resident payee.

**Tax**

**212(1)** Every non-resident person shall pay an income tax of 25% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to the non-resident person as, on account or in lieu of payment of, or in satisfaction of …

[List of possible payments]

* + Applies a flat rate of **25%,** notwithstanding treaty relief.
  + As noted in the rest of the section, the withholding tax applies to deemed amounts and to essentially every sort of payment: Part XIII tax applies irrespective of form or payment or credit.
* Section 214(1) prevents any deductions from being applied against this tax liability.

**No deductions**

**214(1)** The tax payable under section 212 is payable on the amounts described therein without any deduction from those whatever.

* + Part XIII tax is a gross amount of taxation at flat rates: the tax applies identically to all non-resident payees.
* Section 215 places the burden of withholding and remitting Part XIII tax on the resident payor, on behalf of the non-resident payee.

**Withholding and remittance of tax**

**215(1)** When a person pays, credits or provides, or is deemed to have paid, credited or provided, an amount on which an income tax is payable under this Part, or would be so payable if this Act were read without reference to subparagraph 94(3)(a)(viii) and to subsection 216.1(1), the person shall, notwithstanding any agreement or law to the contrary, deduct or withhold from it the amount of the tax and 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.

* + Driven by simple administrative reasons – easier to collect from the Canadian payor.
  + The Canadian resident payor withholds the appropriate tax liability from gross receipts.
    - The non-resident receives the net amount, sans withholding tax, and has no additional obligations.
* Section 215(6) allows for the CRA to collect the withholding tax from the resident payor in the event that the initial withholding was not done.

**Liability for tax**

**215(6)** Where a person has failed to deduct or withhold any amount as required by this section from an amount paid or credited or deemed to have been paid or credited to a non-resident person, that person is liable to pay as tax under this Part on behalf of the non-resident person the whole of the amount that should have been deducted or withheld, and is entitled to deduct or withhold from any amount paid or credited by that person to the non-resident person or otherwise recover from the non-resident person any amount paid by that person as tax under this Part on behalf thereof.

* + Tax collected in this way is in addition to the original gross amount paid out to the non-resident payee.
    - The resident payor can later withhold tax from the non-resident in future dealings, or attempt to collect in civil court for the amounts; the latter is unlikely to be successful.
* **Section 227(1)** provides a liability shield to resident payors for withholding Part XIII tax from non-resident payees.

**Withholding taxes**

**227(1)** No action lies against any person for deducting or withholding any sum of money in compliance or intended compliance with this Act.

* Section 227(8) allows for the CRA to impose penalties for failures to withhold Part XIII tax.

**Penalty**

**227(8)** Subject to subsection (9.5), every person who in a calendar year has failed to deduct or withhold any amount as required by subsection 153(1) or section 215 is liable to a penalty of

(a) 10% of the amount that should have been deducted or withheld; or

(b) where at the time of the failure a penalty under this subsection was payable by the person in respect of an amount that should have been deducted or withheld during the year and the failure was made knowingly or under circumstances amounting to gross negligence, 20% of that amount.

* + That penalty can equal either **10%**, or **20%**, if the failure was either done knowingly or due to gross negligence.
* Section 227(8.3) imposes interest on outstanding withholding tax amounts.

**Interest on amounts not deducted or withheld**

**227(8.3)** A person who fails to deduct or withhold any amount as required by subsection 135(3), 135.1(7), 153(1) or 211.8(2) or section 215 shall pay to the Receiver General interest on the amount at the prescribed rate, computed

(a) in the case of an amount required by subsection 153(1) to be deducted or withheld from a payment to another person, from the fifteenth day of the month immediately following the month in which the amount was required to be deducted or withheld, or from such earlier day as may be prescribed for the purposes of subsection 153(1), to,

(i) where that other person is not resident in Canada, the day of payment of the amount to the Receiver General, and

(ii) where that other person is resident in Canada, the earlier of the day of payment of the amount to the Receiver General and April 30 of the year immediately following the year in which the amount was required to be deducted or withheld;

(b) in the case of an amount required by subsection 135(3) or 135.1(7) or section 215 to be deducted or withheld, from the day on which the amount was required to be deducted or withheld to the day of payment of the amount to the Receiver General; and

(c) in the case of an amount required by subsection 211.8(2) to be withheld, from the day on or before which the amount was required to be remitted to the Receiver General to the day of the payment of the amount to the Receiver General.

* + Interest is calculated from the day the withholding tax was due, to the day that the outstanding payment is ultimately made to the CRA, per s. 227(9.3).

**Interest on certain tax not paid**

**227(9.3)** Where a person fails to pay an amount of tax that, because of section 116, subsection 212(19) or a regulation made under subsection 215(4), the person is required to pay, as and when the person is required to pay it, the person shall pay to the Receiver General interest on the amount at the prescribed rate computed from the day on or before which the amount was required to be paid to the day of payment of the amount to the Receiver General.

* Section 227.1(1) allows for the CRA to collect from the directors of a resident corporate payor who has failed to withhold Part XIII tax (i.e. **director’s liability**).

**Liability of directors for failure to deduct**

**227.1(1)** Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

* Section 227(8.5) prevents any penalties and interest from being levied for failing to remit Part XIII tax for deemed passive income.

**No penalty — certain deemed payments**

**227(8.5)** Subsection (8) does not apply to a corporation in respect of

(a) an amount of interest deemed by subsection 214(16) to have been paid as a dividend by the corporation unless, if the Act were read without reference to subsection 214(16), a penalty under subsection (8) would have applied in respect of the amount; and

(b) an amount deemed by subparagraph 212.3(7)(d)(ii) or subsection 247(12) to have been paid as a dividend by the corporation.

* Regulation 805 prevents double taxation.

**Other Non-Resident Persons**

**805** Subject to section 802, every non-resident person who carries on business in Canada is taxable under Part XIII of the Act on all amounts otherwise taxable under that Part except those amounts that

(a) may reasonably be attributed to the business carried on by the person through a permanent establishment (within the meaning assigned by section 8201) in Canada; or

(b) are required by subparagraph 115(1)(a)(iii.3) of the Act to be included in computing the person’s taxable income earned in Canada for the year.

* + Without this provision, the non-resident payee would be taxed under both Part I and Part XIII.
    - Regulation 805 removes Part XIII tax for amounts attributable to a permanent establishment in Canada.
      * Regulation 8201 supplements this by defining what a permanent establishment is.

**Permanent Establishments**

**8201** … a permanent establishment of a person or partnership (either of whom is referred to in this section as the person) means a fixed place of business of the person, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse if the person has a fixed place of business and, where the person does not have any fixed place of business, the principal place at which the person’s business is conducted, and

(a) where the person carries on business through an employee or agent, established in a particular place, who has general authority to contract for the person or who has a stock of merchandise owned by the person from which the employee or agent regularly fills orders, the person shall be deemed to have a permanent establishment at that place,

(b) where the person is an insurance corporation, the person is deemed to have a permanent establishment in each country in which the person is registered or licensed to do business,

(c) where the person uses substantial machinery or equipment at a particular place at any time in a taxation year, the person shall be deemed to have a permanent establishment at that place,

(d) the fact that the person has business dealings through a commission agent, broker or other independent agent or maintains an office solely for the purchase of merchandise shall not of itself be held to mean that the person has a permanent establishment, and

(e) where the person is a corporation, the fact that the person has a subsidiary controlled corporation at a place or a subsidiary controlled corporation engaged in trade or business at a place shall not of itself be held to mean that the person is operating a permanent establishment at that place,

except that, where the person is resident in a country with which the Government of Canada has concluded a tax treaty in which the expression permanent establishment is given a particular meaning, that meaning shall apply.

***Nestle Enterprises Ltd v Minister of National Revenue*** ([TCC 1991](https://nextcanada.westlaw.com/Document/I7b5c29af8d8b2e47e0440003bacbe8c1/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Taxpayer Bears Burden of Proving the CRA Received Part XIII Withholdings “Forthwith”

* Facts:
  + Nestle paid money to a non-resident on January 17, but did not remit Part XIII tax until February 14.
    - CRA did not receive the amounts in the mail until February 20.
  + The CRA took position that the requirement to withhold taxes “forthwith” means 15 days from the start of the following month, and that Nestle’s remittance did not comply.
  + Nestle argued that “forthwith” means a “reasonable amount of time”, or alternatively, that the requirement should be satisfied by date of postage (the deadline being February 15).
  + Both positions had some support in existing case law.
* Holdings:
  + “Forthwith” means immediately, and as such the CRA’s 15-day policy is appropriate.
  + Burden is on the taxpayer to show that they remitted forthwith.
    - The CRA could therefore change their 15-day policy to any number of days following the end of the month the payment was made.
    - The deadline requires for CRA to have received the remittance before the deadline, not that the taxpayer sent out the remittance before the deadline; no longer important due to electronic remittance.
  + For practical purposes, the fact that the deadline is imposed after the payment, and not the transaction itself, means that payors and payees can arrange the exact date of payment to accommodate the deadline.

***Solomon v R*** ([TCC 2007](https://nextcanada.westlaw.com/Document/I3e50843e04a1613ae0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Remitting Withholdings Does Not Shift Ultimate Tax Burden from Non-Resident Payee

* Facts:
  + Teacher earned income in Canada, retired, became a non-resident, and then received pensions from Waterloo.
    - HRDC also made OAS and CPP payments to Solomon in Switzerland.
  + The Canada/Switzerland Treaty reduces the Part XIII withholding rate on pensions to 15%.
    - However, this reduction does not apply to payments under social security legislation (i.e. the OAS/CPP payments), and for those amounts the default 25% withholding rate instead applies.
  + In 1998, Solomon becomes non-resident in Canada, and he advises both Waterloo and HRDC of this.
    - Both entities continue to pay Solomon the full amounts, without withholding any Part XIII tax.
  + Solomon is assessed for the outstanding Part XIII tax, and the CRA collects from him personally.
    - Solomon argued that Waterloo and HRDC should have been liable, as they both knew he had become non-resident and should have withheld on his behalf.
* Issue was who was responsible for the withholdings.
* Holdings:
  + Section 215(6)’s requirement for withholdings does not shift the ultimate tax burden to the resident payor: the burden remains on the non-resident payee – Solomon.
    - The CRA can collect the outstanding amounts from both HRDC and Waterloo, and those two entities thereafter have a right to recovery from Solomon.
    - All of the parties are ultimately jointly and severally liable for the withholding and interest.
* In this situation, Solomon had several options:
  + As Solomon actually did, he initially (before the CRA’s assessments) received a windfall in that he received amounts that should have been withheld as Part XIII tax.
    - Solomon retained the onus of informing Waterloo and HRDC that they should have withheld.
  + Solomon could have independently remitted the amounts meant for Part XIII tax, either to the CRA directly or by leaving the amounts in a separate fund until the CRA attempted collection.

Management Fees

Relevant ITA Provisions

* Section 212(1)(a) applies Part XIII tax to payments for administrative and executive functions: planning, financial, legal, and administrative services.

**Management fee**

**212(1)(a)** a management or administration fee or charge;

* + As noted in **IT468R**, the focus in defining a management fee should be on substance rather than form.
    - E.g. Paying for the right to use a trademark is not necessarily a management fee; could be a royalty.
* Section 212(4) provides for several express carve-outs to the definition of a management fee.

**Interpretation of management or administration fee or charge**

**212(4)** For the purpose of paragraph 212(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 person if, at the time the non-resident person performed the service

(i) the service was performed in the ordinary course of a business carried on by the non-resident person that included the performance of such a service for a fee, and

(ii) the non-resident person and the payer were dealing with each other at arm’s length, or

(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.

* + Section 212(4)(a) excludes ordinary course, arm’s length management fees, where the service provider is non-resident: the parties must be at arm’s length and the amounts charged must be reasonable.
  + Section 212(4)(b) excludes reimbursements.
    - Per the CRA’s administrative policies, the reimbursement must be precisely at cost with no markup, and the reimbursement amount must (as with arm’s length services) be reasonable.
  + While management fees within these two expenses are exempt from Part XIII tax, the amounts charged may still be subject to Regulation 105 liability, requiring the resident payee to withhold tax.
* Tax treaties may also create exceptions to Part XIII (and other equivalent withholding) tax.
  + Where a treaty is silent on management fees, the fees are included under Article VII as business profits.
    - So long as the non-resident has a permanent establishment in Canada, then the management fees will be taxed under Part I tax rather than Part XIII tax.
      * If the non-resident does not have a permanent establishment, the amounts are only taxable in the non-resident’s country of residence.
  + Consequently, s. 212 rarely applies to impose Part XIII tax, as usually there is a tax treaty or the management fee falls under one of s. 212(4)’s two exceptions.
* Under Reg 805.1, the CRA will issue a certificate noting Part XIII tax does not apply, so long as the non-resident makes an application.

**Payee Certificate**

**805.1** If a person (in this section referred to as the “payee”) files an application under this section with the Minister in respect of the anticipated payment or crediting of an amount to the payee, and the Minister determines that the amount is an amount described in paragraph 805(a) or (b), the Minister shall issue to the payee a certificate that records that determination.

Method of Analysis for Management Fees

* Is the amount a management fee?
* If it is a management fee, is the amount excluded under one of s. 212(4)’s exceptions (reimbursement, or ordinary course, reasonably charged, arm’s length management fees)?
  + If excluded, Part I tax will apply if the amount was earned through business carried out through a permanent establishment; if not, and s. 212(4) is satisfied, then the amounts are only taxable in the non-resident’s state.
* Is there a tax treaty between the states at issue?
  + If there is a treaty, does the treaty specifically discuss management fees?
    - If there is a specific section, that section applies.
    - If there is not a specific section, then Article VII (Business Profits) applies.
      * If the management fee was earned through a permanent establishment, the fee will subject to Part I rather than Part XIII tax.
      * If the management fee was not earned through a permanent establishment, then the fee is subject to tax only in the non-resident’s state.
  + If there is no treaty, consider Regulation 805, which applies Part I rather than Part XIII tax where the management fees were earned through a permanent establishment.
    - Has the non-resident payee filed a Regulation 805.1 certificate to have the fee considered under Regulation 805?
* The analysis generally resolves with Article VII applying; if none of the exceptions apply, Part XIII applies to the fees.

Examples of Management Fees

NRCo owns CanCo. No tax treaty exists between the two states. NRCo provides services, not through a permanent establishment. CanCo pays NRCo an expense reimbursement and a fee.

* The reimbursement is excluded as a management fee due to s. 212(4)(b), assuming the amount is reasonable and without mark-up.
* The fee will only be excluded if it is an ordinary transaction and at arm’s length.
  + NRCo’s ownership of CanCo vitiates the second requirement – fee will be subject to 25% Part XIII tax.

NRCo owns CanCo and USCo. USCo provides services to CanCo, and CanCo pays a fee to USCo.

* Neither exception under s. 212(4) applies – amount is not a reimbursement, and the parties are not at arm’s length.
* However, Article VII of the Can-US Tax Treaty applies to apply Part I tax rather than Part XIII tax on the fees.

NRCo owns CanCo, but not NRServiceCo. No tax treaty applies. NRServiceCo provides services for which CanCo pays a fee for.

* Section 212(4)(b) exception applies so long as the service is in the ordinary course of business – no Part XIII tax on fee.

***Peter Cundill & Associates Ltd v R*** ([FCA 1991](https://nextcanada.westlaw.com/Document/I10b717ce55a163f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Factual Determination of Arm’s Length through Common Law Test

* Facts:
  + A case between Bermuda and Canada: no applicable tax treaty.
  + Cundill owns 50% of PCA Canada, with the other 50% owned by non-arm’s length shareholders.
    - Also owns 100% of PCA Bermuda.
  + PCA Bermuda provides PCA Canada with services, for which PCA Canada pays a fee to PCA Bermuda.
  + The CRA applies Part XIII tax as PCA Bermuda and PCA Canada are not at arm’s length, and thus the s. 212(4) exceptions are not applicable.
* Holdings:
  + Court applied the CRA bulletin to determine whether PCA Bermuda and PCA Canada are at arm’s length, with the factual determination of arm’s length considering three factors:
    - Existence of a common mind which directs the bargaining for both parties to the transaction;
    - Parties to a transaction are acting in concert without separate interests; and
    - “De facto” control.
  + Court concluded that, despite Cundill owning only 50% of PCA Canada, Cundill was the main influence on PCA Canada.
    - Along with Cundill’s 100% ownership in PCA Bermuda, the two PCA’s were not at arm’s length and thus s. 212(4) does not apply.

Interest

Relevant ITA Provisions

* Section 212(1)(b) applies Part XIII tax to interest.

**Interest**

**212(1)(b)** interest that

(i) is not fully exempt interest and is paid or payable

(A) to a person with whom the payer is not dealing at arm’s length, or

(B) in respect of a debt or other obligation to pay an amount to a person with whom the payer is not dealing at arm’s length, or

(ii) is participating debt interest;

* Section 212(3) supplements this by providing various definitions:

**Interest — definitions**

**212(3)** The following definitions apply for the purpose of paragraph (1)(b).

***fully exempt interest*** means

(a) interest that is paid or payable on a bond, debenture, note, mortgage, hypothecary claim or similar debt obligation

(i) of, or guaranteed (otherwise than by being insured by the Canada Deposit Insurance Corporation) by, the Government of Canada,

(ii) of the government of a province,

(iii) of an agent of a province,

(iv) of a municipality in Canada or a municipal or public body performing a function of government in Canada,

(v) of a corporation, commission or association to which any of paragraphs 149(1)(d) to (d.6) applies, or

(vi) of an educational institution or a hospital if repayment of the principal amount of the obligation and payment of the interest is to be made, or is guaranteed, assured or otherwise specifically provided for or secured by the government of a province;

(b) interest that is paid or payable on a mortgage, hypothecary claim or similar debt obligation secured by, or on an agreement for sale or similar obligation with respect to, real property situated outside Canada or an interest in any such real property, or to immovables situated outside Canada or a real right in any such immovable, except to the extent that the interest payable on the obligation is deductible in computing the income of the payer under Part I from a business carried on by the payer in Canada or from property other than real or immovable property situated outside Canada;

(c) interest that is paid or payable to a prescribed international organization or agency; or

(d) an amount paid or payable or credited under a securities lending arrangement that is deemed by subparagraph 260(8)(c)(i) to be a payment made by a borrower to a lender of interest, if

(i) the securities lending arrangement was entered into by the borrower in the course of carrying on a business outside Canada, and

(ii) the security that is transferred or lent to the borrower under the securities lending arrangement is described in paragraph (b) or (c) of the definition qualified security in subsection 260(1) and issued by a non-resident issuer.

***participating debt interest*** means interest (other than interest described in any of paragraphs (b) to (d) of the definition fully exempt interest) that is paid or payable on an obligation, other than a prescribed obligation, all or any portion of which interest is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation. (intérêts sur des créances participatives)

* + “**Fully exempt interest**” relates to debt from a government or an agent of the government (provincial or municipal) or from a public body performing a function of government, certain institutions, and hospitals.
  + “**Participating debt interest**” captures interest that is contingent or dependant on the use of production of property in Canada, or computed by reference to revenue, cash flow, or dividends payable.
    - Essentially debt where the quantum of that debt varies based on how well the business is doing.
      * Captures situations where the lender has an obvious stake in how the business performs.
* If interest is fully exempt interest, then that amount is not subject to Part XIII tax (s. 212(1)(b)(ii)).
* Article XI of the Can-US Tax Treaty provides relief for interest, allowing interest to be taxed only in the state of residence of the recipient of interest, effectively applying a **0% Part XIII rate**.

**Article XI**

**Interest**

1. Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed only in that other State.

2. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures, as well as income assimilated to income from money lent by the taxation laws of the Contracting State in which the income arises. However, the term "interest" does not include income dealt with in Article X (Dividends).

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on, or has carried on, business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article VII (Business Profits) shall apply.

4. For the purposes of this Article, interest shall be deemed to arise in a Contracting State when the payer is that State itself, or a political subdivision, local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated and not in the State of which the payer is a resident.

5. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

6. Notwithstanding the provisions of paragraph 1:

(a) interest arising in the United States that is contingent interest of a type that does not qualify as portfolio interest under United States law may be taxed by the United States but, if the beneficial owner of the interest is a resident of Canada, the gross amount of the interest may be taxed at a rate not exceeding the rate prescribed in subparagraph (b) of paragraph 2 of Article X (Dividends);

(b) interest arising in Canada that is determined with reference to receipts, sales, income, profits or other cash flow of the debtor or a related person, to any change in the value of any property of the debtor or a related person or to any dividend, partnership distribution or similar payment made by the debtor to a related person may be taxed by Canada, and according to the laws of Canada, but if the beneficial owner is a resident of the United States, the gross amount of the interest may be taxed at a rate not exceeding the rate prescribed in subparagraph (b) of paragraph 2 of Article X (Dividends); and

(c) interest that is an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit may be taxed by each State in accordance with its domestic law.

7. Where a resident of a Contracting State pays interest to a person other than a resident of the other Contracting State, that other State may not impose any tax on such interest except insofar as it arises in that other State or insofar as the debt-claim in respect of which the interest is paid is effectively connected with a permanent establishment situated in that other State.

* + The treaty relief does not apply if the person receiving the interest is carrying out business through a permanent establishment in Canada, and the debt producing the interest is connected to the permanent establishment.
    - In such cases, Article VII applies instead.
  + Most tax treaties only apply partial relief, reducing the withholding tax to 10% rather than 0%, as with the Can-US Tax Treaty.

Rents and Royalties

Relevant ITA and Treaty Provisions

* Section 212(1)(d) applies the 25% Part XIII tax to rents and royalties.

**Rents, royalties, etc.**

**212(1)(d)** rent, royalty or similar payment, including, but not so as to restrict the generality of the foregoing, any payment

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

(ii) for information concerning industrial, commercial or scientific experience where the total amount payable as consideration for that information is dependent in whole or in part on

(A) the use to be made of, or the benefit to be derived from, that information,

(B) production or sales of goods or services, or

(C) profits,

(iii) for services of an industrial, commercial or scientific character performed by a non-resident person where the total amount payable as consideration for those services is dependent in whole or in part on

(A) the use to be made of, or the benefit to be derived from, those services,

(B) production or sales of goods or services, or

(C) profits,

but not including a payment made for services performed in connection with the sale of property or the negotiation of a contract,

… [Various exceptions] …

* + Rents are rents.
  + Three general categories contained in this section for royalties:
    - Section 212(1)(d)(i) is a catch-all category for intellectual property.
    - Section 212(1)(d)(ii) captures industrial, commercial, and scientific information and the payments thereof for the payor’s use, production of goods and services, and profits.
    - Section 212(1)(d)(iii) applies to industrial, commercial, and scientific services and the payments thereof for the payor’s use, production of goods and services, and profits.
  + The subsequent paragraphs provide exceptions:
    - Section 212(1)(d)(vi) exempts royalties for copyrights for music, film, and books.
    - Section 212(1)(d)(vii) exempts royalties paid for use of a railway.
    - Section 212(1)(d)(viii) captures joint research and development projects.
    - Section 212(1)(d)(xi) applies to aircraft and furnishings.
* Section 216 of the ITA provides relief in this situation.
  + Section 216(1) allows the non-resident corporation to report $200,000 (net revenue) in the form and pay Part I tax on that amount.
    - Part XIII tax will still be paid initially, as it is the resident payor who is responsible for withholding tax.
  + Section 216(2) then applies to deem the amounts remitted under Part XIII to be paid against the Part I tax, and then any amount of Part XIII tax in excess of Part I will be refunded.
    - End result in the above example is that the non-resident corporation overpays on the Part XIII withholdings, but is refunded the amounts upon filing under s. 216(1).
  + Section 216(4) allows for the non-resident corporation to undertake to the CRA to apply under s. 216(1) within six months of the undertaking.
    - Following that, the resident payor can withhold 25% of the net payment to the non-resident (“amount available to the non-resident”).
    - If the non-resident corporation ultimately fails to make the s. 216(1) application, then the resident corporation is ultimately liable for the balance.
      * For this reason, arm’s length parties are unlikely to make these payments.

Alternatives re rents and timber royalties

216(1) If an amount has been paid during a taxation year to a non-resident person or to a partnership of which that person was a member as, on account of, in lieu of payment of or in satisfaction of, rent on real or immovable property in Canada or a timber royalty, that person may, within two years (or, if that person has filed an undertaking described in subsection (4) in respect of the year, within six months) after the end of the year, file a return of income under Part I for that year in prescribed form. On so filing and without affecting the liability of the non-resident person for tax otherwise payable under Part I, the non-resident person is, in lieu of paying tax under this Part on that amount, liable to pay tax under Part I for the year as though

(a) the non-resident person were a person resident in Canada and not exempt from tax under section 149;

(b) the non-resident person’s income from the non-resident person’s interest in real property, or real right in immovables, in Canada and interest in, or for civil law right in, timber resource properties and timber limits in Canada, and the non-resident person’s share of the income of a partnership of which the non-resident person was a member from its interest in real property, or real right in immovables, in Canada and interest in, or for civil law right in, timber resource properties and timber limits in Canada, were the non-resident person’s only income;

(c) the non-resident person were entitled to no deductions from income for the purpose of computing the non-resident person’s taxable income; and

(d) the non-resident person were entitled to no deductions under sections 118 to 118.9 in computing the non-resident person’s tax payable under Part I for the year.

Idem

216(2) Where a non-resident person has filed a return of income under Part I as permitted by this section, the amount deducted under this Part from

(a) rent on real or immovable property or from timber royalties paid to the person, and

(b) the person’s share of the rent on real or immovable property or from timber royalties paid to a partnership of which the person is a member

and remitted to the Receiver General shall be deemed to have been paid on account of tax under this section and any portion of the amount so remitted to the Receiver General in a taxation year on the person’s behalf in excess of the person’s liability for tax under this Act for the year shall be refunded to the person.

Optional method of payment

216(4) If a non-resident person or, in the case of a partnership, each non-resident person who is a member of the partnership files with the Minister an undertaking in prescribed form to file within six months after the end of a taxation year a return of income under Part I for the year as permitted by this section, a person who is otherwise required by subsection 215(3) to remit in the year, in respect of the non-resident person or the partnership, an amount to the Receiver General in payment of tax on rent on real or immovable property or on a timber royalty may elect under this section not to remit under that subsection, and if that election is made, the elector shall,

(a) when any amount is available out of the rent or royalty received for remittance to the non-resident person or the partnership, as the case may be, deduct 25% of the amount available and remit the amount deducted to the Receiver General on behalf of the non-resident person or the partnership on account of the tax under this Part; and

(b) if the non-resident person or, in the case of a partnership, a non-resident person who is a member of the partnership

(i) does not file a return for the year in accordance with the undertaking, or

(ii) does not pay under this section the tax the non-resident person or member is liable to pay for the year within the time provided for payment,

pay to the Receiver General, on account of the non-resident person’s or the partnership’s tax under this Part, on the expiration of the time for filing or payment, as the case may be, the full amount that the elector would otherwise have been required to remit in the year in respect of the rent or royalty minus the that the elector has remitted in the year under paragraph 216(4)(a) in respect of the rent or royalty.

* Two provisions in the tax treaties apply for rents and royalties.
* Article VI (Income from Real Property) applies for rents.

**Article VI**

**Income from Real Property**

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

2. For the purposes of this Convention, the term "real property" shall have the meaning which it has under the taxation laws of the Contracting State in which the property in question is situated and shall include any option or similar right in respect thereof. The term shall in any case include usufruct of real property, rights to explore for or to exploit mineral deposits, sources and other natural resources and rights to amounts computed by reference to the amount or value of production from such resources; ships and aircraft shall not be regarded as real property.

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

* + - Does not provide any reduction to the 25% withholding rates on rent.
    - Failure to provide any treaty relief is problematic, as demonstrated in the following example:

Non-resident owns an apartment building in Canada with gross rents of $1 million and expenses of $800,000.

* + - When the Canadian property management company pays the non-resident, they are obligated to withhold 25% of the gross amount ($250,000).
    - Results in a $50,000 loss, once expenses are deducted from the $750,000 post-Part XIII tax amounts.
* Article XII (Royalties) applies for royalties: if a royalty arises in Canada, but a US resident is the beneficial owner of those royalties, withholdings are reduced to **10%**.

**Article XII**

**Royalties**

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise, and according to the laws of that State; but if a resident of the other Contracting State is the beneficial owner of such royalties, the tax so charged shall not exceed **10 per cent** of the gross amount of the royalties.

3. Notwithstanding the provisions of paragraph 2,

(a) copyright royalties and other like payments in respect of the production or reproduction of any literary, dramatic, musical or artistic work (other than payments in respect of motion pictures and works on film, videotape or other means of reproduction for use in connection with television);

(b) payments for the use of, or the right to use, computer software;

(c) payments for the use of, or the right to use, any patent or any information concerning industrial, commercial or scientific experience (but not including any such information provided in connection with a rental or franchise agreement); and

(d) payments with respect to broadcasting as may be agreed for the purposes of this paragraph in an exchange of notes between the Contracting States;

arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

4. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including motion pictures and works on film, videotape or other means of reproduction for use in connection with television), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, tangible personal property or for information concerning industrial, commercial or scientific experience, and, notwithstanding the provisions of Article XIII (Gains), includes gains from the alienation of any intangible property or rights described in this paragraph to the extent that such gains are contingent on the productivity, use or subsequent disposition of such property or rights.

5. The provisions of paragraphs 2 and 3 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on, or has carried on, business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, and the right or property in respect of which the royalties are paid is effectively connected to such permanent establishment. In such case the provisions of Article VII (Business Profits) shall apply.

6. For the purposes of this Article,

(a) royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a State a permanent establishment in connection with which the obligation to pay the royalties was incurred, and such royalties are borne by such permanent establishment, then such royalties shall be deemed to arise in the State in which the permanent establishment is situated and not in any other State of which the payer is a resident; and

(b) where subparagraph (a) does not operate to treat royalties as arising in either Contracting State and the royalties are for the use of, or the right to use, intangible property or tangible personal property in a Contracting State, then such royalties shall be deemed to arise in that State.

7. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

8. Where a resident of a Contracting State pays royalties to a person other than a resident of the other Contracting State, that other State may not impose any tax on such royalties except insofar as they arise in that other State or insofar as the right or property in respect of which the royalties are paid is effectively connected with a permanent establishment situated in that other State.

***Stellwaag v R*** ([TCC 2013](https://nextcanada.westlaw.com/Document/Idb393725e19260e6e0440021280d79ee/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Section 216(4) Undertaking Deadline Supersedes Default Section 216(1) Deadline

* Facts:
  + Three US siblings own a Canadian apartment building and hire an agent to collect rents on the property.
  + About $1 million in rents, with each sibling collecting a third of that amount.
  + Siblings undertake to make a s. 216(4) application, with the deadline being June 30.
    - Application received July 21.
  + Consequently, the CRA rejects the siblings’ undertaking and applies Part XIII and a 25% withholding tax.
  + Section 216(1) provides for a two-year deadline if the application is made without undertaking, while if the undertaking is made under s. 216(4) the deadline is six months.
    - Issue was whether the CRA could force the latter deadline where the former is still available.
* Holdings:
  + Where a s. 216(4) undertaking is made, the deadline made under that undertaking applies and s. 216(1)’s deadline no longer applies.
  + Based on the wording of the two provisions and how they distinguish between gross and net remittances, the two provisions cannot be interpreted in such a way that a non-resident could rely on the net remittance formula under s. 216(4) and then still enjoy a “safety net” under s. 216(1).
    - However, the Minister retains discretion to extend filing deadlines for Part I tax.

***Pechet v R*** ([FCA 2009](https://nextcanada.westlaw.com/Document/I79183fa883336b84e0440003bacbe8c1/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Filing Section 216(1) Return Ceases Interest Accumulation, but Does Not Remove Obligation to Pay Accumulated Interest

* Facts:
  + US resident is renting a house in Canada to a tenant; neither tenant nor landlord knew about the Part XIII tax.
    - In 2002, the non-resident homeowner filed tax returns for 1997 – 2001 through the voluntary disclosure process, which allows taxpayers to “come clean” without being subject to penalties and interest.
    - With those returns, the taxpayer files at zero income, electing under s. 216(1) to file through Part I.
      * Expenses were equal to rental income.
  + The CRA assessed at 25% on gross rents, with interest since 1997, and no Part XIII tax and nil Part I tax.
    - Taxpayer thereby received everything they wanted, except for the imposition of interest.
  + Appeal concerned the s. 216(1) tax return, and whether it eliminates Part XIII tax from the dawn of time, or from the time the Part I return is filed.
* Holdings:
  + Upon filing under s. 216(1), interest only ceases on amounts following the filing of that return.
    - Premised on the idea that the government is entitled to Part XIII tax, and that eliminating the interest from those amounts from the beginning of time is contrary to the legislation.
  + Therefore, interest remains owing from 1997 to 2002.

Dividends

Relevant ITA and Treaty Provisions

* Section 212(2) applies Part XIII tax to dividends.

**Tax on dividends**

**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 (other than a capital gains dividend within the meaning assigned by subsection 130.1(4), 131(1) or 133(7.1)); or

(b) a capital dividend.

* + Any taxable and capital dividends paid to a non-resident is subject to a **25%** withholding tax.
    - To avoid burning through one’s capital dividend account, non-residents should have a separate class of shares, allowing the corporation to pay a capital dividend to Canadian residents on one class of shares while paying taxable dividends out to the non-residents on their class of shares.
* Treaty relief is available for dividends, with Article X of the Can-US treaty providing that:

**Article X**

**Dividends**

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 percent 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 (for this purpose, a company that is a resident of a Contracting State shall be considered to own the voting stock owned by an entity that is considered fiscally transparent under the laws of that State and that is not a resident of the Contracting State of which the company paying the dividends is a resident, in proportion to the company’s ownership interest in that entity);

(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.

* + Dividends paid from Canada to the US can be taxed in the US (Art X(1)).
  + However, the dividends may also be taxed in Canada at either (Art X(2)):
    - **5%** – Where the beneficial owner is a company that owns 10% of the voting shares; or
    - **15%** – In any other case.
  + Section 227(8.5) provides that there is no penalty for failing to withhold Part XIII amounts on deemed dividends.

***Prévost Car Inc v R*** ([TCC 2008](https://nextcanada.westlaw.com/Document/I4c10a53c3ed63fd9e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Beneficial Owner of Dividend Determined through Full Factual Inquiry

* Facts:
  + Volvo (Sweden) and Henly’s (UK) own PHBV (Dutch HoldCo), which in turn wholly owns Prevost (Canada).
  + Several withholding rates in each tax treaty: Can-Netherlands: 5%; Can-UK: 10%; Can-Sweden: 15%.
  + The CRA argued that the beneficial owners of Prevost are Henly’s and Volvo, which means that the applicable treaty rates completely change.
    - “Beneficial owner” is not defined in the tax treaties proper, but are defined in the commentary.
    - The corporate group obviously wants the shares to be found to be held by PHBV (the Dutch HoldCo), as the Canada-Netherlands rate is lowest.
* Holdings:
  + TCC found in favour of the taxpayer.
    - Volvo and Henly’s may have had an agreement to flow-through the dividends, but PHBV was never a party to this agreement and thus not legally obligated to flow-through the dividends.
      * Ultimately, PHBV was held to be the beneficial owner.
      * Likely would have lost had PHBV been party to the contract.
  + Together, Volvo and Henly’s could elect 100% of PHBV’s board, which seems inconsistent with the idea that PHBV could make “independent” decisions and thus stand as its own entity.

Summary of Withholdings

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Type of Income** | **ITA Provision** | **ITR Provision** | **Withholding Amount** | **Treaty Article** | **Treaty Relief** | **Party Remitting** | **Applicable Case Law** |
| *COB through PE* |  | **805** | **0%** (Part I applies) |  |  | Owner of PE (805) |  |
| *Salary* | **153(1)(a)** | **102** | Formula |  |  | Employer (153(1)(a)) | Ogden – Withholdings if Canadian employees. |
| *Fees for Services to Non-Resident* | **153(1)(g)** | **105** | **15%** |  |  | Resident Payor (153(1)(g)) | Ogden – Withholdings even if un-profitable or non-taxable in Canada.  Weyerhaeuser – Withholdings only for payments/commissions for services rendered in Canada; no withholdings for services rendered in US; no withholdings for expenses or reimbursements for travel or other expenses. |
| *Branch tax* | **219** | **--** | **5/15/25%** | **X(6)** | **5%**  **0%** on first **$500,000** | Non-resident parent (219(1)) |  |
| *TCP Disposition* | **2(3)(c)**  **115(1)(a)(iii)**  **115(1)(b)**  **116**  **248(1)** |  | **25%**  **50%** (116(5.3) non-capital properties)  **0%** on sale; **25%** on app. (116(2), (4), (5.02), (5.2) Compliance Certificates) | **XIII** | Only a non-resident’s real property, non-business personalty, and specified shares may be taxed. | Resident purchaser (116(5)) | RCI Trust – 25% withholdings must be remitted even for TPP compliance certificates; refund receivable only on filing ITA. |
| *Passive Income (Generally)* | **212(1)** | **805** | **25%**  **0%** (Reg 805 – Part I for COB PE amounts) |  |  | Non-resident payee (Tax – 212(1))  Resident payor (Withholding – 215(1)) | Nestle Enterprises – Part XIII tax must be remitted “forthwith”; taxpayer must show that the CRA received before deadline.  Solomon – Non-resident payee bears ultimate tax burden, regardless of withholdings. |
| *Management Fees* | **212(1)(a)**  **212(4)** | **105**  **805.1** | **25%**  **0%/15%** (212(4)(a) – Ordinary arm’s length fees; 212(4)(b) – Reimbursements; Reg 105 may still apply)  **0%** (805.1 payee certificate: Reg 805/Part I tax applies) | **VII** | **0%** (Part I instead, if COB PE) | Non-resident payee (Tax – 212(1))  Resident payor (Withholding – 215(1)) | Peter Cundill – Arm’s length determined factually. |
| *Interest* | **212(1)(b)**  **212(3)** |  | **25%**  **0%** (212(1)(b)(ii) – Rate for fully exempt interest) | **XI**  **VII** | **0%**  **0%** (Part I applies, if COB PE) | Non-resident payee (Tax – 212(1))  Resident payor (Withholding – 215(1)) |  |
| *Rents and Royalties* | **212(1)(d)**  **216** |  | **25%**  0% (216(1) – Report $200,000 and pay Part I on that, with Part XIII liability then refunding (216(2); 216(4) – Non-resident can undertake to apply under 216(1))) | **VI**  **XII** | **25%** (Rents – No reduction)  **10%** (Royalties, if non-resident is beneficial owner) | Non-resident payee (Tax – 212(1))  Resident payor (Withholding – 215(1)) | Stellwaag – 216(4) undertaking deadline prioritized over 216(1)’s deadline.  Pechet – Interest accumulates on outstanding withholdings until remitted; previous interest remains owed even after filing return. |
| *Dividends* | **212(2)** |  | **25%** | **X** | **5%** (Beneficial owner of dividend is company that owns 10% of issuer)  **15%**  (Default) | Non-resident payee (Tax – 212(1))  Resident payor (Withholding – 215(1)) | Prévost Car Inc – Determining beneficial owner of a dividend to apply treaty relief depends on full factual inquiry. |

III: Taxation of Resident Worldwide Income

A: Income Earned Outside Canada by Canadian Residents

Income Earned Outside Canada by Canadian Residents

Relevant ITA Provisions

* Section 2(1) in itself does not impose tax on a resident’s worldwide income, but is the provision responsible for subjecting a resident’s worldwide income to taxation

**Tax payable by persons resident in Canada**

**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.

* + “Income” interpreted as including both worldwide and domestic income.

Foreign Tax Credits and Deductions

Relevant ITA Provisions

* Two ways to prevent double taxation on income earned worldwide:
  + Claim a **foreign tax credit**; or
  + Claim a deduction relating to that foreign income.
  + E.g. Canadian resident earns $1,000 of interest income in the US. US assesses a tax of 15% on that income.
    - The resident is therefore paid $850, but reports $1,000 and is required to pay 20% tax on this to the Canadian government.
      * Effective rate of taxation then becomes 35%, but the resident is entitled to claim a foreign tax credit, and the result is that the 20% tax payable is reduced by the 15% already paid out.
* Section 126(7) provides relevant definitions, with the two important definitions being the difference between “**business-income tax**” and “**non-business-income tax**”:

**Definitions**

**126(7)** In this section,

***business-income tax*** paid by a taxpayer for a taxation year in respect of businesses carried on by the taxpayer in a country other than Canada (referred to in this definition as the “business country”) means, subject to subsections (4.1) to (4.2), the portion of any income or profits tax paid by the taxpayer 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 taxpayer from a business carried on by the taxpayer in the business country, but does not include a tax, or the portion of a tax, that can reasonably be regarded as relating to an amount that

(a) any other person or partnership has received or is entitled to receive from that government, or

(b) was deductible under subparagraph 110(1)(f)(i) in computing the taxpayer’s taxable income for the year;

…

***non-business-income tax*** paid by a taxpayer for a taxation year to the government of a country other than Canada means, subject to subsections (4.1) to (4.2), the portion of any income or profits tax paid by the taxpayer for the year to the government of that country that

(a) was not included in computing the taxpayer’s business-income tax for the year in respect of any business carried on by the taxpayer in any country other than Canada,

(b) was not deductible by virtue of subsection 20(11) in computing the taxpayer’s income for the year, and

(c) was not deducted by virtue of subsection 20(12) in computing the taxpayer’s income for the year,

but does not include a tax, or the portion of a tax,

(c.1) that is in respect of an amount deducted because of subsection 104(22.3) in computing the taxpayer’s business-income tax,

(d) that would not have been payable had the taxpayer not been a citizen of that country and that cannot reasonably be regarded as attributable to income from a source outside Canada,

(e) that may reasonably be regarded as relating to an amount that any other person or partnership has received or is entitled to receive from that government,

(f) that, where the taxpayer deducted an amount under subsection 122.3(1) from the taxpayer’s tax otherwise payable under this Part for the year, may reasonably be regarded as attributable to the taxpayer’s income from employment to the extent of the lesser of the amounts determined in respect thereof under paragraphs 122.3(1)(c) and 122.3(1)(d) for the year,

(g) that can reasonably be attributed to a taxable capital gain or a portion thereof in respect of which the taxpayer or a spouse or common-law partner of the taxpayer has claimed a deduction under section 110.6, or

(h) [Repealed, 2013, c. 33, s. 13]

(i) that can reasonably be regarded as relating to an amount that was deductible under subparagraph 110(1)(f)(i) in computing the taxpayer’s taxable income for the year;

* Section 20(11) provides for a **deduction** for any foreign tax payable in excess of **15%** of the income or profit (i.e. foreign tax payable in excess of the amount of the tax credit).

**Foreign taxes on income from property exceeding 15%**

**20(11)** In computing the income of an individual from a property other than real or immovable property for a taxation year after 1975 that is income from a source outside Canada, there may be deducted the amount, if any, by which,

(a) such part of any income or profits tax paid by the taxpayer to the government of a country other than Canada for the year as may reasonably be regarded as having been paid in respect of an amount that has been included in computing the taxpayer’s income for the year from the property,

exceeds

(b) 15% of the amount referred to in paragraph 20(11)(a).

* E.g. Canadian earns $1,000 of interest income from the United States.
  + US levies a 20% taxation rate and Canada a 25% rate, resulting in $200 payable to the US and $250 to Canada.
  + The US FTC provides a 15% tax credit against the 25% Canadian tax rate and the $250 Canadian tax payable.
    - This leaves the total tax liability at $300.
  + The foreign tax credit deduction then applies.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | US | Canada | Canada (20(11)) | Canada (20(12)) |
| US Interest Income | 1,000 | 1,000 | 1,000 | 1,000 |
| US Tax (20%) | 200 |  |  |  |
| FTC Deduction | (200 – 150) |  |  | 200 |
| Canadian Tax (25%) |  | 250 | 237 | 200 |
| FTC (15%) |  | 150 | 150 |  |
|  | 200 | 100 | 87 | 200 |
| Total tax paid |  | 300 | 287 | 200 |

* Section 20(12) provides for a different **deduction**.

**Foreign non-business income tax**

**20(12)** In computing the income of a taxpayer who is resident in Canada at any time in a taxation year from a business or property for the year, there may be deducted any amount that the taxpayer claims that does not exceed the non-business income tax paid by the taxpayer for the year to the government of a country other than Canada (within the meaning assigned by subsection 126(7) read without reference to paragraphs (c) and (e) of the definition non-business income tax in that subsection) in respect of that income, other than any of those taxes paid that can, in whole or in part, reasonably be regarded as having been paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation.

* + Captures the residual category of income which contains all income but business income in the foreign country.
* Section 126(1) allows for a **credit** for any tax paid on non-business income tax, subject to certain subtractions.

**Foreign tax deduction**

**126(1)** A taxpayer who was resident in Canada at any time in a taxation year may deduct from the tax for the year otherwise payable under this Part by the taxpayer an amount equal to

(a) such part of any non-business-income tax paid by the taxpayer for the year to the government of a country other than Canada (except, where the taxpayer is a corporation, any such tax or part thereof that may reasonably be regarded as having been paid by the taxpayer in respect of income from a share of the capital stock of a foreign affiliate of the taxpayer) as the taxpayer may claim,

not exceeding, however,

* Section 126(2) applies to provide taxpayers with a tax **credit** for any “business-income tax” – income or profits tax that the taxpayer paid in the year to a foreign country which is not attributable to income from a business the taxpayer carried on in the foreign country, was not deductible under s. 20(11), and was not deducted under s. 20(12).

**Idem**

**126(2)** Where a taxpayer who was resident in Canada at any time in a taxation year carried on business in the year in a country other than Canada, the taxpayer may deduct from the tax for the year otherwise payable under this Part by the taxpayer an amount not exceeding the least of

(a) such part of the total of the business-income tax paid by the taxpayer for the year in respect of businesses carried on by the taxpayer in that country and the taxpayer’s unused foreign tax credits in respect of that country for the 10 taxation years immediately preceding and the 3 taxation years immediately following the year as the taxpayer may claim,

(b) the amount determined under subsection 126(2.1) for the year in respect of businesses carried on by the taxpayer in that country, and

(c) the amount by which

(i) the tax for the year otherwise payable under this Part by the taxpayer

exceeds

(ii) the amount or the total of amounts, as the case may be, deducted under subsection 126(1) by the taxpayer from the tax for the year otherwise payable under this Part.

* + Foreign tax credits must be used before carryover, and non-business credits must be used before business credits; each is done on a country-by-country basis (e.g. German credits cannot be used against US income).
* Section 126(6) provides several rules as interpretive aids:

**Rules of construction**

**126(6)** For the purposes of this section,

(a) the government of a country other than Canada includes the government of a state, province or other political subdivision of that country;

(b) where a taxpayer’s income for a taxation year is in whole or in part from sources in more than one country other than Canada, subsections (1) and (2) shall be read as providing for separate deductions in respect of each of the countries other than Canada;

(c) if any income from a source in a particular country would be tax-exempt income but for the fact that a portion of the income is subject to an income or profits tax imposed by the government of a country other than Canada, the portion is deemed to be income from a separate source in the particular country; and

(d) if, in computing a taxpayer’s income for a taxation year from a business carried on by the taxpayer in Canada, an amount is included in respect of interest paid or payable to the taxpayer by a person resident in a country other than Canada, and the taxpayer has paid to the government of that other country a non-business income tax for the year with respect to the amount, the amount is, in applying the definition qualifying incomes in subsection (7) for the purpose of subsection (1), deemed to be income from a source in that other country.

***Nadeau v The Queen*** ([TCC 2007](https://nextcanada.westlaw.com/Document/I10b717e1bbb863f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – General Analysis for Definition of a Tax Applicable for International Purposes

* Facts:
  + US citizen resident in Canada with 2001 income of $33,000 from teaching.
    - Canadian tax before FTC is $3,726.
    - Paid premiums to Mainstate retirement of $245 and claimed those premiums and US taxes in computing her FTC in Canada.
  + The CRA allowed the US tax payable, but not the Mainstate retirement amounts.
    - Recall Eurig Estate’s definition of a “tax”:
      * Enforceable by the law.
      * Imposed under the authority of the legislature.
      * Public body levies it.
      * Intended for a public purpose.
* Holdings:
  + Analysis of Mainstreet premiums as a tax:
    - Enforceable by law – Mainstreet was state-administered body.
    - Was imposed under statute.
    - Levied by a public body.
    - Premiums were for the benefit of teachers, but not for a public purpose.
  + Due to the premiums not being a tax, they could not count towards FTC.
  + Compare to CPP payments, where premiums go into general revenues, there is no segregated body for the funds, which is sufficient for CPP amounts to be considered a tax.

***Bujnowski v The Queen*** ([FCA 2006](https://nextcanada.westlaw.com/Document/I10b717eef24763f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – TCC May Amend Calculations of Tax Payable for FTC

* Facts:
  + US citizen living in the US for 10 months in 2001, with the rest of the time in Canada.
  + $2,400 net tax payable, with taxpayer applying a FTC of $14,787.
* Holdings:
  + TCC judge found Bujnowski to be factually resident in Canada, despite the proper application of the common law test likely finding Bujnowsi to be factually resident in US.
  + FCA judge amended and found Bujnowski to be deemed resident by the tax treaty tiebreaker rules.
    - Within jurisdiction to amend findings of residence and calculation of the amount of tax payable following applicable of the FTC.
      * Reduced amount claimable from the FTC to $12,426.79 – the proper net amount of tax payable following application of the FTC.

B: Taxation of Certain Foreign Entities

Foreign Affiliates

Defining and Determining Foreign Affiliates

* A Canadian corporation holds a **foreign affiliate** where it owns 10% or more of a corporate entity resident in a jurisdiction other than Canada.
  + Determining whether something is a corporation is a question of fact, in Canada – a body corporate with limited liability for its shareholders.
    - This includes the American concept of a LLC, which has flow-through tax treatment of its income: Canada has concluded the LLC is a corporation despite the special tax treatment.
  + If ownership is less than 10%, that is a **portfolio relationship**.
  + If ownership is between 10% and 50%, that is a **foreign affiliate** relationship.
  + If ownership is greater than 50%, that is a **controlled foreign affiliate** relationship.
    - A controlled foreign affiliateis a foreign affiliate controlled, de jure or de facto, by another corporation.
* **Active business income** (ABI) earned outside of Canada through a foreign affiliate is taxed in a favourable manner – that amounts is taxed in a sort of remittance basis, where it is taxed in the foreign jurisdiction and is not taxed in Canada until receipt.
  + ABI is not inactive business income (e.g. adventures in the concern or nature of trade); there must be an active element to the earning of business income.
  + Passive business income is not taxed on a favourable manner based on the **foreign accrual property income** (FAPI) rules, being taxed on foreign accrual and taxation basis.
* Tax treatment depends on several factors:
  + Type of income.
  + Active or passive income.
  + Source entity of the income (e.g. portfolio, foreign affiliate).
  + Timing of receipt of the income.
  + Existence of a treaty.
* **Foreign affiliate** is defined in s. 95(1) through a conjunctive definition:

***foreign affiliate***, at any time, of a taxpayer resident in Canada means a non-resident corporation in which, at that time,

(a) the taxpayer’s 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 (where each such equity percentage is determined as if the determinations under paragraph (b) of the definition equity percentage in subsection 95(4) were made without reference to the equity percentage of any person in the taxpayer or in any person related to the taxpayer) is not less than 10%,

except that a corporation is not a foreign affiliate of a non-resident-owned investment corporation; (société étrangère affiliée)

* + A foreign corporation will be a foreign affiliate if:
    - The Canadian corporate taxpayer personally has at least **1%** equity percentage (direct and indirect); and
    - The Canadian corporate taxpayer and all persons related have at least **10%** equity percentage.
* **Equity percentage** is determined through its own definition in s. 95(4) as the person’s percent of ownership of shares in the particular corporation.

***equity percentage*** at any time of a person, in any particular corporation, is the total of

(a) the person’s direct equity percentage at that time in the particular corporation, and

(b) all percentages each of which is the product obtained when the person’s equity percentage at that time in any corporation is multiplied by that corporation’s direct equity percentage at that time in the particular corporation

except that for the purposes of the definition participating percentage in subsection 95(1), paragraph (b) shall be read as if the reference to “any corporation” were a reference to “any corporation other than a corporation resident in Canada”; (pourcentage d’intérêt)

* This definition is supplemented by that of **direct equity percentage**¸ also in s. 95(4).

***direct equity percentage*** at any time of any person in a corporation is the percentage determined by the following rules:

(a) for each class of the issued shares of the capital stock of the corporation, determine the proportion of 100 that the number of shares of that class owned by that person at that time is of the total number of issued shares of that class at that time, and

(b) select the proportion determined under paragraph (a) for that person in respect of the corporation that is not less than any other proportion so determined for that person in respect of the corporation at that time,

and the proportion selected under paragraph (b), when expressed as a percentage, is that person’s direct equity percentage in the corporation at that time; (pourcentage d’intérêt direct)

* In determining the equity percentage, take the direct equity percentage, plus the “indirect equity percentage”.
  + The **direct equity percentage** is determined by the taxpayer’s ownership of shares in the company (in whichever class is highest).
  + The **indirect equity percentage** is a function of total equity percentage in a corporation multiplied against that second corporation’s equity percentage in the corporation in question.
* Say a CanCo owns 25% of the Class A non-voting shares and 50% of the Class B voting shares in USCo1. CanCo also owns 5% of the shares in USCo2. USCo1 owns 30% of the shares in USCo2. USCo2 owns 15% of the shares in USCo3. All of the USCo’s are non-resident in Canada.
  + CanCo’s direct equity percentage in USCo1 is 50%.
    - 50% is greater than 25%.
  + CanCo’s indirect equity percentage in USCo1 is 0%.
  + Therefore, CanCo’s equity percentage in USCo1 is 50%.
  + CanCo’s direct equity percentage in USCo2 is 5%.
  + CanCo’s indirect equity percentage in USCo2 is 15%.
    - Calculated by multiplying CanCo’s equity percentage in USCo1 against USCo1’s equity percentage in USCo2.
  + Therefore, CanCo’s equity percentage in USCo2 is 20%.
  + CanCo’s direct equity percentage in USCo3 is 0%.
  + CanCo’s indirect equity percentage in USCo3 is 3%.
    - Calculated by multiplying CanCo’s equity percentage in USCo2 against USCo2’s equity percentage in USCo3.
  + Therefore, CanCo’s equity percentage in USCo3 is 3%.

|  |  |  |  |
| --- | --- | --- | --- |
|  | USCo1 | USCo2 | USCo3 |
| Direct Equity Percentage | 50 | 5 | 0 |
| Indirect Equity Percentage | 0 | 15 | 3 |
| Equity Percentage | 50 | 20 | 3 |
| CanCo Foreign Affiliate? | Yes | Yes | No |

* + De jure, USCo1 is a foreign affiliate of CanCo.
    - Equity percentage must be 1% or greater, and the equity percentage of CanCo and its related persons is 10% or greater.
      * Both conditions satisfied by CanCo having an equity percentage of 50% in USCo1.
  + De jure, USCo2 is a foreign affiliate of CanCo.
    - Equity percentage is 20%.
  + De jure, USCo3 can only be a foreign affiliate of CanCo if CanCo’s related parties amount to an additional 7% (or more) of ownership in USCo3.
    - The inclusion of “indirect equity percentage” accounts for the ownership in USCo3 from CanCo’s ownership in USCo1 and USCo2.
* **Controlled foreign affiliate** is defined in s. 95(1):

***controlled foreign affiliate***, at any time, of a taxpayer resident in Canada, means

(a) a foreign affiliate of the taxpayer that is, at that time, controlled by the taxpayer, or

(b) a foreign affiliate of the taxpayer that would, at that time, be controlled by the taxpayer if the taxpayer owned

(i) all of the shares of the capital stock of the foreign affiliate that are owned at that time by the taxpayer,

(ii) all of the shares of the capital stock of the foreign affiliate that are owned at that time by persons who do not deal at arm’s length with the taxpayer,

(iii) all of the shares of the capital stock of the foreign affiliate that are owned at that time by the persons (each of whom is referred to in this definition as a “relevant Canadian shareholder”), in any set of persons not exceeding four (which set of persons shall be determined without reference to the existence of or the absence of any relationship, connection or action in concert between those persons), who

(A) are resident in Canada,

(B) are not the taxpayer or a person described in subparagraph (ii), and

(C) own, at that time, shares of the capital stock of the foreign affiliate, and

(iv) all of the shares of the capital stock of the foreign affiliate that are owned at that time by persons who do not deal at arm’s length with any relevant Canadian shareholder; (société étrangère affiliée contrôlée)

* + Paragraph (a) strictly examines whether the taxpayer owns over 50% of the shares in the foreign corporation.
    - Using the above example, USCo1 would not be a controlled foreign affiliate of CanCo under paragraph (a), because there is no de jure control (no more than 50% shares).
  + Paragraph (b) is a “deeming” rule, examining the taxpayer if they owned all the shares held by certain parties:
    - Paragraph (b)(i) captures the taxpayer’s direct ownership of shares in the foreign corporation.
    - Paragraph (b)(ii) captures the shares owned by the taxpayer’s non-arm’s length parties.
      * Non-arm’s length can either be deemed due to being related (in certain relationships) or factually due to having a directing mind.
    - Paragraph (b)(iii) captures the shares owned by **relevant Canadian shareholders** – any group of four arm’s length shareholders, resident in Canada, excluding the taxpayer or their non-arm’s length parties.
      * To return to the above example, if there existed any other Canadian at arm’s length holding Class B voting shares in USCo1, then USCo1 becomes a foreign affiliate of CanCo.
      * Due to this rule, any group of four Canadian resident shareholders at arm’s length who together hold at least 50% of shares in a corporation would result in a foreign affiliate.
    - Paragraph (b)(iv) then examines the non-arm’s length parties of the relevant Canadian shareholders.
      * Both paragraphs (b)(ii) & (b)(iv) do not specify that the non-arm’s length parties must be resident in Canada; the non-arm’s length parties can be non-resident.

Tax Treatment of a Foreign Affiliate – The Surplus Accounts

* Regulation 5907(11.2) sets out residency of a foreign affiliate.

**5907(11.2)** For the purposes of this Part, a foreign affiliate of a corporation is, at any time, deemed not to be resident in a country with which Canada has entered into a comprehensive agreement or convention for the elimination of double taxation on income unless

(a) the affiliate is, at that time, a resident of that country for the purpose of the agreement or convention;

(b) the affiliate would, at that time, be a resident of that country for the purpose of the agreement or convention if the affiliate were treated, for the purpose of income taxation in that country, as a body corporate;

…

* + Paragraph (a) simply means that if a corporation is resident in the other country due to the tax treaty, then it is not resident in Canada.
  + Paragraph (b) was added because of how some corporations are not considered corporations under Canadian law, but so long as they are treated as a corporation in the foreign country, the residency rule will apply.
* Together, s. 12(1)(k) and Subdivision I (s. 90(1)) require dividends from a foreign corporation to be included in income.

**Foreign corporations, trusts and investment entities**

**12(1)(k)** any amount required by subdivision i to be included in computing the taxpayer’s income for the year;

**Dividend from non-resident corporation**

**90(1)** In computing the income for a taxation year of a taxpayer resident in Canada, there is to be included any amount received by the taxpayer at any time in the year as, on account or in lieu of payment of, or in satisfaction of, a dividend on a share owned by the taxpayer of the capital stock of a non-resident corporation.

* There are four surplus accounts:
  + **Exempt Surplus**: Generally speaking, inter-corporate exempt surplus is not taxed. Consists of:
    - ABI from a designated treaty country; and
    - Dividends from exempt surplus.
  + **Taxable Surplus**: Is subject to tax upon dividend. Includes:
    - ABI from a non-designated treaty country;
    - FAPI (essentially retained earnings on foreign property); and
    - Taxable capital gains on ABI property from a non-designated treaty country.
      * E.g. Selling a piece of equipment used in a business in a country that there is no treaty with.
  + **Hybrid Surplus**: Consists of:
    - Capital gains on foreign affiliates or partnership interests.
      * **Not** taxable capital gains, but *capital* gains.
  + **Pre-Acquisition Surplus**: Everything else.
* Say exempt surplus is $100, and taxable surplus is $200, and the Canadian resident receives a $500 dividend.
  + Presumption is that the $200 not accounted from comes from pre-acquisition surplus.
* Dividends from exempt surplus requires the inclusion of the dividend as income (ss. 12(1)(k) & 90(1)), but s. 113(1)(a) then provides a deduction for that amount, such that the dividend from exempt surplus is not taxable.

**Deduction in respect of dividend received from foreign affiliate**

**113(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 for the year, an amount equal to the total of

(a) an amount equal to such portion of the dividend as is prescribed to have been paid out of the exempt surplus, as defined by regulation (in this Part referred to as “exempt surplus”) of the affiliate,

* + Only applies to a corporate taxpayer resident in Canada.
  + Does not provide a deduction for any withholdings paid.
* Dividends from hybrid surplus are captured by s. 113(1)(a.1).

**113(1)(a.1)** an amount equal to the total of

(i) one-half of the portion of the dividend that is prescribed to have been paid out of the hybrid surplus, as defined by regulation (in this Part referred to as “hybrid surplus”), of the affiliate, and

(ii) the lesser of

(A) the total of

(I) the product obtained when the foreign tax prescribed to be applicable to the portion of the dividend referred to in subparagraph (i) is multiplied by the amount by which

1. the corporation’s relevant tax factor for the year

exceeds

2. one-half, and

(II) the product obtained when

1. the non-business-income tax paid by the corporation applicable to the portion of the dividend referred to in subparagraph (i)

is multiplied by

2. the corporation’s relevant tax factor for the year, and

(B) the amount determined under subparagraph (i),

* Dividends from taxable surplus are address in s. 113(1)(b).

**113(1)(b)** an amount equal to the lesser of

(i) the product obtained when the foreign tax prescribed to be applicable to such portion of the dividend as is prescribed to have been paid out of the taxable surplus, as defined by regulation (in this Part referred to as “taxable surplus”) of the affiliate is multiplied by the amount by which

(A) the corporation’s relevant tax factor for the year

exceeds

(B) one, and

(ii) that portion of the dividend,

* + Factor (A) basically reduces to the relevant tax factor minus one.
  + Factor (B) is the value of the dividend.
  + The “relevant tax factor” is calculated by the reciprocal of the general tax rate minus the rate reduction.
    - This reduces to **4** for a corporation, and **1.9** for an individual.
  + Subparagraph (b)(i) captures the **underlying foreign tax** – the amount of foreign tax that was paid before receipt of the dividend.
* Section 113(1)(c) requires calculation of the non-business income tax payable by the corporation.

**113(1)(c)** an amount equal to the lesser of

(i) the product obtained when

(A) the non-business-income tax paid by the corporation applicable to such portion of the dividend as is prescribed to have been paid out of the taxable surplus of the affiliate

is multiplied by

(B) the corporation’s relevant tax factor for the year, and

(ii) the amount by which such portion of the dividend as is prescribed to have been paid out of the taxable surplus of the affiliate exceeds the deduction in respect thereof referred to in paragraph 113(1)(b), and

* + Subparagraph (c)(i) captures the relevant tax factor multiplied against non-business income tax paid.
* Take a CanCo with 50% shares in two different foreign affiliates.
  + FA1 is in a treaty country, and FA2 is in a non-treaty country.
  + Both foreign affiliates are earning ABI.
  + In 2018, FA1 pays a dividend of $120,000.
    - This is subject to a 5% withholding tax of $6,000.
    - The dividend is then subject to an 18% corporate tax rate, leading to $21,600 tax payable.
  + CanCo is required under s. 90(1) to include a $60,000 income inclusion from the dividend.
    - CanCo has 50% of the shares in FA1, and FA1 paid out a $120,000 dividend.
  + CanCo can claim a s. 113(1)(a) deduction equal to $60,000, resulting in tax payable of $0.
    - The dividend is paid out from exempt surplus, as the account is maintained from ABI carried out in a treaty country.
  + Due to being in a non-treaty country, FA2’s ABI will feed into taxable surplus.
  + FA2 pays out a dividend of $100,000.
    - Subject to a 10% withholding tax of $10,000.
    - Subject to a 5% corporate tax rate.
      * Generally an indication that the rate is with a non-treaty country, as Canada would not enter into a tax treaty with a country with a drastically different corporate tax rate.
    - Results in taxable surplus of $500,000.
      * 0.95(*x*) = $500,000, where *x* is equal to the pre-tax income.
        + *x* is equal to $526,316, meaning that FA2 paid corporate tax of $26,316.
  + CanCo received a dividend of $50,000 from FA2 (50% multiplied against $100,000).
    - The underlying tax on that dividend is $2,632.
      * 0.95(*x*) = $50,000. *x* is equal to $52,632.
    - A pre-tax dividend of $52,632.
  + Take the underlying tax and multiply it by the relevant tax factor minus one (4 – 1).
    - $2,632 multiplied against 3
  + From FA2, there must be an income inclusion under s. 90(1) of $50,000.
    - Section 113(1)(a) does not apply.
    - Section 113(1)(b) computes between the lesser of $7,896 (3 times $2,632) and $50,000.
      * Deduct from the dividend $7,896, leaving taxable income of $42,104.
    - Section 113(1)(c) allows an additional deduction for the lessor of two values.
      * Section 113(1)(c)(i) returns the withholding tax multiplied against the relevant tax factor – 4 times $5,000 = $20,000.
      * Section 113(1)(c)(ii) returns $42,104.
      * The lesser of the two is $20,000, allowing an additional deduction.
    - The result is that there is an income inclusion of $22,104, taxed at the 27% corporate tax resulting in $5,968.08.
  + $2,632 underlying foreign tax.
  + $5,000 withholding tax.
  + $5,968.08 tax payable after deductions for taxable surplus.
  + Total tax payable of $13,600.08, which is roughly equivalent to the $13,500 of tax payable had the $50,000 dividend been earned in Canada and subject to the 27% corporate tax rate.

***CanWest MediaWorks Inc v The Queen*** ([TCC 2007](https://nextcanada.westlaw.com/Link/Document/FullText?findType=Y&pubNum=6407&serNum=2010628442&originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)); [FCA 2008](https://nextcanada.westlaw.com/Document/I43f90fe4a7d45385e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – FAPI Always Taxable; Treaty Interpretation: Specific Provisions Supersede General Provisions

* Facts:
  + Controlled foreign affiliate with FAPI.
  + Article 30 of the Canada-Barbados Tax Treaty says that nothing in the treaty prevents Canada from imposing tax on FAPI.
    - Another article notes there is a five-year limitation period for any income taxed in Barbados.
  + The Canadian corporation is audited, close to the five-year limitation period.
    - The CRA has CanWest sign a waiver, allowing for the CRA to assess beyond the five years.
      * Usually, these are issued just prior to the limitation period, and the CRA asserts that, without the waiver, the CRA will assess based on what they know.
        + Effectively results in the entire tax return no longer being statute barred.
      * Waivers are specific to the issue under audit, and everything else is thereafter statute-barred.
        + Here, the CRA would only be able to re-assess FAPI, and everything else would run aground of the limitation period.
  + Assessment was issued after the five-year limitation period, and taxpayer argues that there was no basis to impose that re-assessment given the waiver and the limitation period.
* Issue is which article in the treaty was paramount, and by extension, whether there is nothing to prevent tax on FAPI.
* Holdings (TCC):
  + Nothing in the treaty prevents taxation on FAPI, so long as it is done in five years.
  + Appeal allowed for taxpayer.
* Holdings (FCA):
  + Overturns TCC decision.
  + Article 30 is more specific in that it specifically addresses FAPI and notes that nothing will prevent it from being taxed, while the five-year limitation period is general.
    - The specific Article overrules the general Article.

Foreign Accrued Property Income

Foreign Accrued Property Income Defined and Policy Rationale

* Corporate investment income is taxable in Canada at 50%, with a 30% refund through the RDTOH mechanism.
* What happens if a Canadian corporation instead invests its investment income in a foreign jurisdiction?
  + There would likely be a deduction under ss. 113(1)(b) & 113(1)(c), but there is also a very lengthy deferral while the investment monies is abroad.
* The FAPI regime requires that immediate tax be paid on the controlled foreign affiliate’s investment.
  + That amount is added to the ACB of the shares, and upon payment of a dividend, ACB would be reduced.
  + Taxes are paid immediately, and not when the investment is actually received in Canada.
    - From a policy point of view, FAPI is in place to discourage investing in low tax rate jurisdictions and to eliminate the deferral benefit for that.
    - Furthermore, investment activity abroad does not return an immediate domestic cash flow, while the Canadian foreign investor still takes advantage of tax-funded services in Canada.
      * Helps to ensure cash flow to the Canadian government during the length of the foreign investment.
* FAPI applies to each class of shares.
* Together with s. 12(1)(k), s. 91(1) requires FAPI to be included in income.

**Amounts to be included in respect of share of foreign affiliate**

**91(1)** In computing the income for a taxation year of a taxpayer resident in Canada, there shall be included, in respect of each share owned by the taxpayer of the capital stock of a controlled foreign affiliate of the taxpayer, as income from the share, the percentage of the foreign accrual property income of any controlled foreign affiliate of the taxpayer, for each taxation year of the affiliate ending in the taxation year of the taxpayer, equal to that share’s participating percentage in respect of the affiliate, determined at the end of each such taxation year of the affiliate.

The FAPI Workflow

* Establish tax status (s. 95(1)).
  + **Portfolio investment** (<10% ownership)**;**
  + **Foreign affiliate** (10% – 50% equity percentage); or
  + **Controlled foreign affiliate** (>50% ownership) – FAPI only applies to CFA’s.
* Sum FAPI.
* Include FAPI in Canadian shareholder’s income (ss. 12(1)(k) & 91(1)).
* Claim **foreign tax deduction** (**4 times** the foreign tax payable).
* Calculate **net FAPI** by reducing FAPI by the deduction.
* Calculate **share of net FAPI** by multiplying net FAPI against proportion of share ownership.
* Calculate Canadian tax based on the share of net FAPI (applying Canadian corporate tax rates).
* Add/subtract ACB adjustment to shares:
  + ; OR
  + .
  + FAT = **Foreign Accrual Tax** (the value of the foreign tax deduction (foreign tax payable \* 4)).
  + Increase in ACB will equal the increase in retained earnings; once those earnings are paid out, ACB will return.
    - Addition/subtraction of ACB will always be equal to the share of net FAPI (i.e. retained earnings).
* Dividend received reduces ACB.
  + If there is a negative ACB, a capital gain is triggered.
* Say there is a 10% foreign corporate tax rate applied against a FAPI of $1,000.
  + Foreign tax payable is $100, multiplied by 4 resulting in a $400 deduction.
  + Net FAPI is therefore $600.
    - For a full deduction and 0% corporate tax payable, the foreign corporate rate must be 25% or more.
      * Demonstrates the policy rationale: preventing tax deferrals from investing in low-corporate tax countries.
        + Still no cash flow until repatriation, but a conscious policy decision has been made to allow that because the investment is being driven by non-tax reasons (as the foreign rate is either equal or higher to Canada’s).
  + If shares had an opening ACB of $100, add $1,000 for FAPI, and then deduct $100 for the FAT.
    - ACB will then be $1,000, equal to the FAPI.
  + The net FAPI will be subject to approximately $150 of Canadian corporate tax.
    - Together with the FAT, that results in about $250 of tax – the same as what would be taxed if it had been invested from the beginning in Canada.
  + Once the dividend is paid out from the controlled foreign affiliate, no tax will be paid due to the increase in ACB from the FAPI tax, as that amount has already been paid.
* Say shares open with an ACB of $200, and those shares generate $1,000 of FAPI subject to FAT of $100.
  + The ACB will be $1,100.
  + The controlled foreign affiliate has FAPI of $1,000 and FAT of $100, meaning retained earnings of $900.
    - Adding the $900 to the ACB brings ACB to $1,100.
    - If the retained earnings are paid out as a dividend, ACB will be reduced to its original value of $200.

Trusts and Offshore Investment Fund Property

Non-Resident Trusts

* Residence of a trust is the same as that of its trustees.
* If a trust is settled by a non-resident, the trust is not Canadian resident unless there is a Canadian resident beneficiary.
  + Trust can be deemed to be Canadian resident if its settlor or beneficiary is Canadian resident.
  + If there is a non-resident contributor to a trust, the trust will not be taxable unless there is a Canadian resident beneficiary or settlor.
    - Each of these parties is defined in s. 94.
* Between the s. 94 deeming rules, and the central management and control test, offshore trusts have basically been eliminated in Canada.

Offshore Investment Fund Property

* FAPI only applies to investments through a controlled foreign affiliate.
* Section 94.1 imposes a tax of **1/12** of the rate of interest for the offshore investment, plus an additional 2%.

**Offshore investment fund property.**

**94.1(1)** If in a taxation year a taxpayer holds or has an interest in property (referred to in this section as an “offshore investment fund property”)

(a) that is a share of the capital stock of, an interest in, or a debt of, a non-resident entity (other than a controlled foreign affiliate of the taxpayer or a prescribed non-resident entity) or an interest in or a right or option to acquire such a share, interest or debt, and

(b) that may reasonably be considered to derive its value, directly or indirectly, primarily from portfolio investments of that or any other non-resident entity in

(i) shares of the capital stock of one or more corporations,

(ii) indebtedness or annuities,

(iii) interests in one or more corporations, trusts, partnerships, organizations, funds or entities,

(iv) commodities,

(v) real estate,

(vi) Canadian or foreign resource properties,

(vii) currency of a country other than Canada,

(viii) rights or options to acquire or dispose of any of the foregoing, or

(ix) any combination of the foregoing,

and it may reasonably be concluded, having regard to all the circumstances, including

…

there shall be included in computing the taxpayer’s income for the year the amount, if any, by which

(f) the total of all amounts each of which is the product obtained when

(i) the designated cost to the taxpayer of the offshore investment fund property at the end of a month in the year

is multiplied by

(ii) 1/12 of the total of

(A) the prescribed rate of interest for the period that includes that month, and

(B) two per cent

exceeds

(g) the taxpayer’s income for the year (other than a capital gain) from the offshore investment fund property determined without reference to this subsection.

IV: International Tax Planning and Abuse

A: International Tax Planning

Use and Misuse of Tax Havens and Treaty Havens

Treaty Shopping

* Offshore planning today is dramatically different from how it was decades ago, due to the considerable legislative and international steps taken to deny offshore tax evasion and avoidance.
* “**Treaty shopping**” is the process by which a taxpayer organizes a tax structure to take advantage of specific treaty rates, such that there is a reduction of tax payable.
  + E.g. CanCo lender loans money to a US borrower, which pays interest back to the CanCo lender, which is subject to a withholding tax of 10% – an example of a no-planning set-up.
  + E.g. CanCo invests money into a Netherlands corporation for shares (Netherlands provides equity in exchange for money).
    - Article X of the Canada-Netherlands treaty provides for a withholding tax of 5% on the dividends, which is lower than the 10% withholding tax on interest.
      * NethCo loans money to a USCo, which pays interest back to the NethCo; the US-Neth treaty provides for no withholding taxes on interest.
    - The result of this arrangement is that the CanCo is subject to 5% less withholding tax.

***Crown Forest Industries Ltd v R*** ([SCC 1995](https://nextcanada.westlaw.com/Document/I10b717d04f4263f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Treaty Shopping Tax Avoidance and is Not Discouraged or Encouraged ((See supra for treaty interpretation; residency)

* Holdings:
  + Paragraph 55 comments on the idea of treaty shopping:

It seems to me that both Norsk and the respondent are seeking to minimize their tax liability by picking and choosing the international tax regimes most immediately beneficial to them. Although there is nothing improper with such behaviour, I certainly believe that it is not to be encouraged or promoted by judicial interpretation of existing agreements.

* + - Treaty shopping is tax avoidance, and not tax evasion.
    - The courts should not be encouraging it, but they do not need to actively discourage it either.
  + The court examined the idea proposed by the parties (para 57):

Assume that...a foreign corporation is engaged in a trade or business in the U.S. and earns $100 of "effectively connected income" (which is taxable in the U.S.) and $1,000,000 of foreign source "non-connected income" (assume income from Canada) which is not taxable in the United States.

… It is submitted that this was not intended by the contracting states, and that it would encourage enterprises to "treaty shop" by routing their income through a particular state in order to avail themselves of benefits that were designed to be given only to residents of the contracting states.

* + - In response, the Court afforded the following (para 58):

I find this possibility to be highly undesirable. "Treaty shopping" might be encouraged in which enterprises could route their income through particular states in order to avail themselves of benefits that were designed to be given only to residents of the contracting states. This result would be patently contrary to the basis on which Canada ceded its jurisdiction to tax as the source country, namely that the U.S. as the resident country would tax the income.

* + While not a full and comprehensive determination on the appropriateness of treaty shopping, the most important conclusion is that it should not encouraged nor actively addressed.

Section 4.1 of the Income Tax Conventions Interpretation Act

* Section 4.1 of the *Income Tax Conventions Interpretation Act* was amended in 2005 to include the following:

**Application of section 245 of the Income Tax Act**

**4.1** Notwithstanding the provisions of a convention 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.

* + Prior to the inclusion of this section, it was widely believed that the GAAR did not apply to treaties.
    - GAAR was not in place in the treaty, and the treaty is paramount to the Act.
* Supplementing this is s. 245(4)(a)(iv) of the ITA:

**Application of subsection (2)**

**245(4)** Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of

(iv) a tax treaty, or

* Between the two, this helps to redress any possibility that the treaty overrides the Act and the use of the GAAR pursuant thereof: the GAAR is clearly applicable to the treaty.
  + The *Income Tax Interpretation Act* undeniably applies as part of the treaty; consequently, s. 4.1 can apply to prevent paramountcy of the treaty over the ITA from prohibiting application of the GAAR.

***Antle v R*** ([TCC 2009](https://nextcanada.westlaw.com/Document/I746090205dc24d74e0440003bacbe8c1/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Execution and Planning Both Necessary for Tax Avoidance

* Facts:
  + Series of transactions involving a trust in the Barbados.
    - Because of the definition at the time in s. 94 of the ITA, the trust was deemed to be a Canadian resident.
  + Because the entity was a trust, there was the potential for a spousal rollover.
    - Taxpayer has property which he rollovers under s. 73(1), which is possible because the trust was a spousal trust – a trust established by a settlor to provide income to the settlor’s spouse.
      * Spouse must be entitled to all of the trust’s income and capital for their lifetime, and no one else but the spouse is allowed to encroach on the income and capital.
      * The spousal trust is a vehicle ultimately treated the same as one’s spouse.
        + If the taxpayer transfers property to their spouse, there is an automatic deemed rollover under s. 73(1) that deems the purchase price to be at cost.

No immediate tax consequences as a result of the transfer of title.

* + - * + The rollover is automatic and applies even if the taxpayer sells their property to the spouse for cash; one must elect out of the application of s. 73(1).
  + Result of the rollover is that the spousal trust hold property which has FMV far in excess of its cost.
  + The trust then sells the property to the spouse at cost.
    - Because of the wording in the Canada-Barbados tax treaty, that gain is reportable and “taxable” in the Barbados.
      * However, due to Barbados using the pre-1973 Canadian income tax rules, that gain is not taxable as it is a capital gain, which only became taxable post-1973.
  + The spouse then sells to a third party, with the FMV of the shares being equal to its ACB.
  + The ultimate result of the transactions was the spouse realized a $1.3 million gain without any tax payable.
* Holdings:
  + Transactions were a sham that aimed only to create a series of transactions that took advantage of the Canada-Barbados tax treaty and s. 73(1) in a way that was never intended by Parliament.
  + Minister applied the GAAR and s. 4(1), but the judgment instead turned on the trust’s improper constitution.
    - Lacked certainty of intent and subject matter.
      * There was never any actual intent to transfer shares to the trust; the shares were always transferred with the intent of being relayed to the third party.
    - Without a trust, all of the transactions never actually exist.
  + Justice Miller provided the following comments surrounding tax planning (para 58):

With certainty of intention and certainty of subject matter in question and, more significantly, no actual transfer of shares, there is no properly constituted trust: the Trust never came into existence. This conclusion emphasizes how important it is, in implementing strategies with no purpose other than avoidance of tax, that meticulous and scrupulous regard be had to timing and execution. Backdating of documents, fuzzy intentions, lack of transfer documents, lack of discretion, lack of commercial purpose, delivery of signed documents distributing capital from the trust prior to its purported settlement, all frankly miss the mark — by a long shot. They leave an impression of elaborate window dressing. 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 Trust's appeal is therefore quashed. With respect to Mr. Antle's appeal, with no valid trust he either sold the shares to his wife and triggered a gain in his hands or he rolled the shares to his wife and had the gain attributed back to him. Either way, he has been correctly assessed on the resulting capital gain, and his appeal is dismissed.

* + - The same paragraph also contains the core holdings upon the validity of the transactions.
    - Execution and planning are both necessary for successful tax avoidance.

Treaty-Protected Property and Treaty-Protected Business

* Section 248(1) provides the following definitions for treaty-protected business and property:

***treaty-protected business*** of a taxpayer at any time means a business in respect of which any income of the taxpayer for a period that includes that time would, because of a tax treaty with another country, be exempt from tax under Part I

***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

* + Treaty-protected property distinguishes between “income from the disposition of property” and “gain from the disposition of property”.
    - (Capital) Gain is for the sale of capital property; (business) income is for the sale of business property.
* Section 111(9) notes that any losses on treaty-protected property cannot be carried forward or used as a deduction.

**Exception**

**111(9)** In this section, a taxpayer’s non-capital loss, net capital loss, restricted farm loss, farm loss and limited partnership loss for a taxation year during which the taxpayer was not resident in Canada shall be determined as if

(a) in the part of the year throughout which the taxpayer was non-resident, if section 114 applies to the taxpayer in respect of the year, and

(b) throughout the year, in any other case,

the taxpayer had no income other than income described in any of subparagraphs 115(1)(a)(i) to (vi), the taxpayer’s only taxable capital gains, allowable capital losses and allowable business investment losses were from dispositions of taxable Canadian property (other than treaty-protected property) and the taxpayer’s only other losses were losses from the duties of an office or employment performed by the taxpayer in Canada and businesses (other than treaty-protected businesses) carried on by the taxpayer in Canada.

* + The property is treaty-exempt in both favourable (where there is a loss to be deducted) and unfavourable (where there is potential tax) situations for the taxpayer.
* Article XXIX A is a **limitation on benefits clause**.

**Article XXIX A**

**Limitation on Benefits**

1. For the purposes of the application of this Convention by a Contracting State,

(a) a qualifying person shall be entitled to all of the benefits of this Convention; and

(b) except as provided in paragraphs 3, 4 and 6, a person that is not a qualifying person shall not be entitled to any benefits of this Convention.

* + Only **qualifying persons** are entitled to the benefits under the treaty: natural persons, the US or Canada or a province or state thereof, corporations or trusts, certain corporations, and certain tax-exempt entities.
  + Non-qualifying persons can still qualify for benefits under paragraphs (3), (4), and (6).
    - (3) is the active business trader test – for persons actively engaged in trading of shares, the treaty will nonetheless apply.
    - (4) is the derivative benefits test – a corporate party is entitled to the benefits of dividend, interest, and royalties if the owner of that corporation would be personally entitled to those benefits, subject to two tests.
      * Requires the ownership be through the “principal class of shares” – the shares which represent the majority of the voting power and value of the corporation.
      * For the derivative benefits test to apply, **90%** of the votes and values of the shares in the corporation must be owned by a qualifying person, and **50%** of the disproportionate shares must be owned by the same.
        + A “disproportionate class of shares” generally refers to preferred shares.
    - (6) allows for taxpayers to apply to their competent authorities for a discretionary grant of benefits.

***MIL (Investments) SA v The Queen*** ([TCC 2006](https://nextcanada.westlaw.com/Document/I1c210b38c563335fe0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Application of the GAAR to the Treaty

* Facts:
  + Non-resident of Canada begins acquiring shares in 1993 in a CanCo - DFR.
    - Transfers those shares to MIL, a Cayman Islands company; MIL then holds 11.9% of the DFR shares.
  + Some of the shares are then transferred from MIL to InCo, a Canadian resident corporation, with MIL receiving InCo shares as consideration.
    - Following those transfers, MIL has only 9.8% of the DFR shares; less than 10% ownership.
  + In 1995, MIL is continued into Luxembourg.
    - Continuance results in a deeming that the corporation was always subject to the law of the jurisdiction into which they are continued.
  + MIL then disposes of its InCo shares for $65 million, and later disposes of its remaining DFR shares for $430 million.
    - MIL claims treaty exemptions on both, with the result that no capital gain tax was paid.
  + The CRA ultimately applied the GAAR.
    - MIL argued that there was no avoidance transaction because MIL sold its shares in DFR to get under the 10% threshold.
* Holdings:
  + No doubt that there was a tax benefit.
  + On the avoidance transaction issue, there were many commercial reasons for selling DFR shares, and the taxpayer simply chose the lowest tax jurisdiction to accomplish that goal.
    - The TCC concluded that the transactions had a bona fide business purpose, and despite being the most advantageous in terms of tax consequences, that does not constitute an avoidance transaction.

International Tax Planning Considerations

Form of Business Organization

* US businessman wishes to establish a closet business in Canada.
  + If the business is conducted through a permanent establishment in Canada, profits will be taxed in Canada.
  + What if the business was conducted only through a warehouse? Is that a permanent establishment?
    - If the business is such they hire a third party to store everything in a warehouse, then that would not amount to a permanent establishment.
      * Would only need to pay excise and customs on shipping up to Canada form the US, but no tax would be payable in Canada on the business itself because it is not out of a permanent establishment.
  + As soon as the business has employees in Canada, it is likely to be a permanent establishment, which will result in the corporation’s sale revenue being taxed in Canada.
  + Various options for the permanent establishment:
    - Trust.
    - Proprietorship.
    - Corporation (subsidiary).
      * The resulting CanCo will pay tax at Canadian corporate rates on its business income.
      * Pay out any retained earnings through dividends, which will be subject to a 25% withholding tax.
        + Treaty relief reduces that to a 5% withholding tax.
    - Joint venture.
    - Partnership.
      * Incorporate a CanCo and partner with it, with the resulting partnership flowing through 99.9% of the income to the USCo and the remaining 0.1% to the CanCo.
      * Partnerships are transparent for tax purposes – the partners to the partnership are taxable.
      * Is the flow-through partnership income to the USCo taxable?
        + Is the partnership carrying on business?

Yes.

* + - * + Through a permanent establishment?

Yes.

* + - * + The partnership profits are consequently taxed in Canada, but how is that income reported in Canada?

USCo is earning income in Canada through a partnership, and needs to report income as a result through a corporate tax return.

If it was instead a natural person, then they must file a personal tax return instead.

* + - Branch.
      * The foreign corporation sending people in to begin carrying out business.
      * Must file a branch return on Canadian revenue and expenses.
        + Could also allocate some overhead expenses from the US to Canada through accounting.
      * Also subject to a branch tax on the difference between revenue and liabilities, which is assumed to be returned to the US.
        + First $500,000 of “deemed income” is exempt under the treaty from branch tax - $25,000 o tax.
  + Additional concerns for any US nationals who are employed in the Canadian permanent establishment.
    - Potential tax consequences for those individuals.
      * Non-residents employed in Canada pay Part I tax.
        + First $10,000 of employment income is not taxable in Canada.
        + Any amount the individual earns in Canada is free provided they are in Canada for less than 183 days, and the wages are not borne by a Canadian permanent establishment.
    - If the individual is being paid by CanCo, then CanCo withholds; if the individual is being paid by USCo, then USCo withholds.
    - Apply for a waiver.
    - File a treaty-based return.

Unlimited Liability Corporations

* Frequently used by the US for inbound investments into Canada.
  + There is no liability with a ULC: any liability flows through the corporation to its shareholders.
  + ULC’s are fiscally transparent in the USA (gains and losses flow-through to shareholders), as without limited liability they are considered either partnerships or proprietorships, depending on the number of shareholders.
* Article IV(7) of the US-Can treaty denies treaty relief for hybrid entities by not treating them as resident.

7. An amount of income, profit or gain shall be considered not to be paid to or derived by a person who is a resident of a Contracting State where:

(a) the person is considered under the taxation law of the other Contracting State to have derived the amount through an entity that is not a resident of the first-mentioned State, but by reason of the entity not being treated as fiscally transparent under the laws of that State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that amount had been derived directly by that person; or

(b) the person is considered under the taxation law of the other Contracting State to have received the amount from an entity that is a resident of that other State, but by reason of the entity being treated as fiscally transparent under the laws of the first-mentioned State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that entity were not treated as fiscally transparent under the laws of that State.

* + A ULC is a business corporation for purposes of Canadian law, and a fiscally transparent entity for US law, thus being a hybrid entity which not entitled to treaty relief.
* When a dividend is paid from a ULC to the USCo, it is treated under Art IV(7)(b) as not being resident in Canada, and thereby a 25% withholding rate on the dividends.
  + To work around the 25% withholding rate, the ULC will funnel its retained earnings into PUC, not dividends.
    - Two options with retained earnings of $1 million.
      * Pay out dividend of $1 million; or
      * Increase PUC of $1 million.
    - Following either action, retained earnings in the ULC will be $0.
      * In Canada, a PUC increase without an increase in assets or decrease in liabilities or decrease of PUC of another class of shares (artificial increase of PUC) will result in a deemed dividend.
        + Under US law, the same amount would not be considered a deemed dividend, so the withholding rate is reduced to 5%.
    - The effect of increasing PUC gets around the 25% withholding rate and instead applies a 5% withholding rate, equivalent to the treaty relief for dividends under Article X(2)(a), despite the ULC not being entitled to treaty relief.

B: International Financing, Borrowing, and Transfers

Thin Capitalization and International Financing

Relevant ITA Provisions

* Section 18(4) of the ITA provides for the thin capitalization rules.

**Limitation on deduction of interest**

**18(4)** Notwithstanding any other provision of this Act (other than subsection (8)), in computing the income for a taxation year of a corporation or a trust from a business (other than the Canadian banking business of an authorized foreign bank) or property, no deduction shall be made in respect of that proportion of any amount otherwise deductible in computing its income for the year in respect of interest paid or payable by it on outstanding debts to specified non-residents that

(a) the amount, if any, by which

(i) the average of all amounts each of which is, in respect of a calendar month that ends in the year, the greatest total amount at any time in the month of the outstanding debts to specified non-residents of the corporation or trust,

exceeds

(ii) 1.5 times the equity amount of the corporation or trust for the year,

is of

(b) the amount determined under subparagraph (a)(i) in respect of the corporation or trust for the year.

* + Two things normally happen with interest in a foreign corporation:
    - Interest is deductible in the foreign corporation and thus no foreign tax is payable.
    - Interest is paid without withholding tax.
  + Amount of interest that is non-deductible is calculated through s. 18(4), and that amount which is non-deductible is considered to be a deemed dividend under s. 214(16).
* Thin capitalization means that the corporation is heavy on debt, and thus interest.
  + If light on equity (and by extension heavy on debt), then any interest paid out is subject to limits on deduction.
    - Either capitalize with appropriate amounts of equity and pay a dividend, or have interest with thin capitalization and experience a deemed dividend.
* Section 18(4) essentially requires **40%** equity before there is no deemed dividend.
  + A = Interest otherwise deductible (i.e. total amount of interest).
  + B = Average of debt to specified non-residents.
  + C = Equity amount (opening retained earnings, average of contributed surplus, and paid up capital each month).

Applying the Section 18(4) Thin Capitalization Equation

* Say the Canadian average debt each month is $2,500 (B).
  + Interest paid on that to a non-resident is $250 (A).
  + Equity amount is $1,000 (C).
  + The result is that there is $100 of non-deductible interest.
    - There would need to be $1,400 of equity before there would be no deemed dividend on the interest.
* Say the Canadian average debt each month is $2,100 (B).
  + Interest is $250 (A).
  + Equity amount is $1,400 (C).
  + Result is that there is $0 of non-deductible interest.
* Say the Canadian average debt each month is $2,000 (B).
  + Interest is $250.
  + Equity amount is $1,500 (C).
  + Negative deemed to be nil.
* Total investment in the CanCo remains constant at $3,500 in each example.
* If s. 18(4) returns a deemed dividend, then Part XIII tax will be payable on those amounts as dividends under s. 212(2).
  + However, s. 227(8.5) notes that no penalties will be levied for failing to pay Part XIII tax on a deemed dividend.

**No penalty — certain deemed payments**

**227(8.5)** Subsection (8) does not apply to a corporation in respect of

(a) an amount of interest deemed by subsection 214(16) to have been paid as a dividend by the corporation unless, if the Act were read without reference to subsection 214(16), a penalty under subsection (8) would have applied in respect of the amount; and

(b) an amount deemed by subparagraph 212.3(7)(d)(ii) or subsection 247(12) to have been paid as a dividend by the corporation.

***Speciality Manufacturing Ltd v R*** ([FCA 1999](https://nextcanada.westlaw.com/Document/I10b717d2991963f0e0440003ba0d6c6d/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Determination of Arm’s Length Full Factual Analysis: No Arm’s Length Party Would Lend to Thinly Capitalized Corporation

* Facts:
  + All shares in SML, a CanCo, are held by spouses resident in the USA.
  + They transfer all shares to Ace, a USCo, which is also wholly owned by CanCo.
    - Transfer triggers a gain, which is non-taxable under the treaty.
  + Another USCo, WFS is owned by the husband.
  + Seafirst, a USCo, loans money to WFS and Ace; WFS and Ace in turn loan that money to SML.
  + SML then deducts interest on that money, which the CRA disallows under s. 18(4).
    - Interest charged is identical to that charged by Seafirst on the amounts loaned to WFS.
      * Seafirst is an arm’s length lender and is thus not a specific non-resident, the result being that the thin capitalization rules do not apply to Seafirst.
      * The rules do apply to SML and WFS and Ace.
  + Taxpayers argue that Article IX of the US-Can treaty provides relief and overrides s. 18(4).
    - Cite interest rates charged by Seafirst to the monies loaned to WFS and Ace, which are identical and thus fulfill Article IX(1)’s conditions.

**Article IX**

**Related Persons**

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.

* + - If amount of interest charged between non-arm’s length persons is the same as that charged between arm’s length persons, there cannot be adjustment of amounts (such as under s. 18(4)).
* Holdings:
  + Debt to equity ratio in the corporations was 100,000:1.
    - No arm’s length party would ever loan to a corporation in such a way that would create that debt to equity ratio.
    - Consequently, the arrangements did “differ from those which would be made between unrelated persons”, as no one would loan in those circumstances.
      * Consequently, Article IX did not apply to provide relief, and s. 18(4)’s thin capitalization adjustments could be applied to result in a deemed dividend.

Amounts Owing by a Non-Resident

* Section 17(1) is a deemed interest rule on debt owed by a non-resident to a domestic creditor.

**Amount owing by non-resident**

**17(1)** If this subsection applies to a corporation resident in Canada in respect of an amount owing to the corporation (in this subsection referred to as the “debt”), the corporation shall include in computing its income for a taxation year the amount determined by the formula

A – B

where

***A*** is the amount of interest that would be included in computing the corporation’s income for the year in respect of the debt if interest on the debt were computed at the prescribed rate for the period in the year during which the debt was outstanding; and

***B*** is the total of all amounts each of which is

(a) an amount included in computing the corporation’s income for the year as, on account of, in lieu of or in satisfaction of, interest in respect of the debt,

(b) an amount received or receivable by the corporation from a trust that is included in computing the corporation’s income for the year or a subsequent taxation year and that can reasonably be attributed to interest on the debt for the period in the year during which the debt was outstanding, or

(c) an amount included in computing the corporation’s income for the year or a subsequent taxation year under subsection 91(1) that can reasonably be attributed to interest on an amount owing (in this paragraph referred to as the “original debt”) — or if the amount of the original debt exceeds the amount of the debt, a portion of the original debt that is equal to the amount of the debt — for the period in the year during which the debt was outstanding if

(i) without the existence of the original debt, subsection (2) would not have deemed the debt to be owed by the non-resident person referred to in paragraph (1.1)(a),

(ii) the original debt was owed by a non-resident person or a partnership each member of which is a non-resident person, and

(iii) where subsection (11.2) applies to the original debt,

(A) an amount determined under paragraph (11.2)(a) or (b) in respect of the original debt is an amount referred to in paragraph (2)(a), and because of the amount referred to in paragraph (2)(a), the debt is deemed to be owed by the non-resident person referred to in paragraph (1.1)(a), and

(B) the original debt was owing by an intermediate lender to an initial lender or by an intended borrower to an intermediate lender (within the meanings of those terms assigned by subsection (11.2)).

* + Section 17 requires at least one non-resident debtor, one resident corporate creditor, and one debt.
  + Variable A is equal to the amount of interest payable at the prescribed rate (not the actual interest charged).
  + Variable B is a sum of several amounts:
    - Interest the resident creditor actually received (s. 17(1)(a));
    - Interest received or receivable from a trust that is reasonably attributable to interest on the debt (s. 17(1)(b)); and
    - Section 91(1) FAPI (s. 17(1)(c)).
  + The difference between the variables is the amount of deemed interest the resident creditor must include as a income (with the usual Part XIII withholdings applying, although s. 227.5(8) prevents penalties/interest).
* Sections 17(2) & 17(3) provide an anti-avoidance rule for an indirect loan.

**Anti-avoidance rule — indirect loan**

**17(2)** For the purpose of this section and subject to subsection (3), where

(a) a non-resident person owes an amount at any time to a particular person or partnership (other than a corporation resident in Canada), and

(b) it is reasonable to conclude that the amount or a portion of the amount became owing, or was permitted to remain owing, to the particular person or partnership because

(i) a corporation resident in Canada made a loan or transfer of property, or

(ii) the particular person or partnership anticipated that a corporation resident in Canada would make a loan or transfer of property,

either directly or indirectly, in any manner whatever, to or for the benefit of any person or partnership (other than an exempt loan or transfer),

the non-resident person is deemed at that time to owe to the corporation an amount equal to the amount, or the portion of the amount, as the case may be, owing to the particular person or partnership.

**Exception to anti-avoidance rule — indirect loan**

**17(3)** Subsection (2) does not apply to an amount owing at any time by a non-resident person to a particular person or partnership where

(a) at that time, the non-resident person and the particular person or each member of the particular partnership, as the case may be, are controlled foreign affiliates of the corporation resident in Canada; or

(b) at that time,

(i) the non-resident person and the particular person are not related or the non-resident person and each member of the particular partnership are not related, as the case may be,

(ii) the terms or conditions made or imposed in respect of the amount owing, determined without reference to any loan or transfer of property by a corporation resident in Canada described in paragraph (2)(b) in respect of the amount owing, are such that persons dealing at arm’s length would have been willing to enter into them at the time that they were entered into, and

(iii) if there were an amount of interest payable on the amount owing at that time that would be required to be included in computing the income of a foreign affiliate of the corporation resident in Canada for a taxation year, that amount of interest would not be required to be included in computing the foreign accrual property income of the affiliate for that year.

* Section 17(8) provides exceptions to the inclusion of interest from debts owed by non-residents.
  + If a CanCo is making a loan to somebody, and then it is used in an active business that is not FAPI, there is no requirement to loan money at a reasonable interest rate.

**Exception**

**17(8)** Subsection (1) does not apply to a corporation resident in Canada for a taxation year of the corporation in respect of an amount owing to the corporation by a non-resident person if the non-resident person is a controlled foreign affiliate of the corporation throughout the period in the year during which the amount is owing to the extent that it is established that the amount owing

(a) arose as a loan or advance of money to the affiliate that the affiliate has used, throughout the period that began when the loan or advance was made and that ended at the earlier of the end of the year and the time at which the amount was repaid,

(i) for the purpose of earning

(A) income from an active business, as defined in subsection 95(1), of the affiliate, or

(B) income that was included in computing the income from an active business of the affiliate under subsection 95(2), or

(ii) for the purpose of making a loan or advance to another controlled foreign affiliate of the corporation where, if interest became payable on the loan or advance at any time in the period and the affiliate was required to include the interest in computing its income for a taxation year, that interest would not be required to be included in computing the affiliate’s foreign accrual property income for that year; or

(b) arose in the course of an active business, as defined in subsection 95(1), carried on by the affiliate throughout the period that began when the amount owing arose and that ended at the earlier of the end of the year and the time at which the amount was repaid.

Foreign Affiliate Dumping

* Section 212.3 addresses **foreign affiliate dumping** – investments from a CanCo, which is controlled by a foreign corporation, into a controlled foreign affiliate of the CanCo.

**Foreign affiliate dumping — conditions for application**

**212.3(1)** Subsection (2) applies to an investment in a non-resident corporation (in this section referred to as the “subject corporation”) made at any time (in this section referred to as the “investment time”) by a corporation resident in Canada (in this section referred to as the “CRIC”) if

(a) the subject corporation is immediately after the investment time, or becomes as part of a transaction or event or series of transactions or events that includes the making of the investment, a foreign affiliate of

(i) the CRIC, or

(ii) a corporation that does not deal at arm’s length with the CRIC (if the condition in this paragraph is satisfied because of this subparagraph and not because of subparagraph (i), such a corporation is referred to in paragraph (b) as an “other Canadian corporation”);

(b) the CRIC or an other Canadian corporation is immediately after the investment time, or becomes after the investment time and as part of a transaction or event or series of transactions or events that includes the making of the investment, controlled by a non-resident corporation (in this section referred to as the “parent”), and any of the following conditions is satisfied:

(i) if, at the investment time, the parent owned all shares of the capital stock of the CRIC and the other Canadian corporation, if applicable, that are owned — determined without reference to paragraph (25)(b) in the case of partnerships referred to in this subparagraph and as if all rights referred to in paragraph 251(5)(b), of the parent, each person that does not deal at arm’s length with the parent and all of those partnerships, were immediate and absolute and the parent and each of the other persons and partnerships had exercised those rights at the investment time — by the parent, persons that are not dealing at arm’s length with the parent and partnerships of which the parent or a non-resident person that is not dealing at arm’s length with the parent is a member (other than a limited partner within the meaning assigned by subsection 96(2.4)), the parent would own shares of the capital stock of the CRIC or the other Canadian corporation that

(A) give the holders of those shares 25% or more of all of the votes that could be cast at any annual meeting of the shareholders in respect of all shares of the capital stock of the CRIC or the other Canadian corporation, as the case may be, or

(B) have a fair market value of 25% or more of the fair market value of all of the issued and outstanding shares of the capital stock of the CRIC or the other Canadian corporation, as the case may be,

(ii) the investment is an acquisition of shares of the capital stock of a subject corporation by a CRIC to which this subparagraph applies because of subsection (19), or

(iii) under an arrangement entered into in connection with the investment, a person or partnership, other than the CRIC or a person related to the CRIC, has in any material respect the risk of loss or opportunity for gain or profit in respect of a property that can reasonably be considered to relate to the investment; and

(c) neither subsection (16) nor (18) applies in respect of the investment.

* + Section 212.3 applies when:
    - A CanCo made an “investment”, direct or indirect, in a foreign corporation (s. 212.3(10));
    - At the time of investment, a foreign corporation must also hold either 25% of the votes in the CanCo, or 25% of the value of the CanCo’s issued shares (s. 212.3(1)(b));
    - Immediately after that investment (or as part of transactions in relation to that investment), that CanCo is controlled by a foreign corporation (s. 212.3(1)(b));
    - Immediately after that investment (or as part of transactions in relation to that investment), that foreign corporation becomes a foreign affiliate of the CanCo (s. 212.3(1)(a)).
  + Section 212.3 would not apply where:
    - The controlled foreign affiliate’s business activities are more closely related to the CanCo’s activities than to the CanCo’s controlling foreign corporation (s. 212.3(16) must also be satisfied); or
    - Where s. 212.3(18) is satisfied during a corporate reorganization.
  + If s. 212.3 applies, then s. 212.3(2) applies the following consequences:
    - Any non-share consideration the CanCo paid for the investment into the CanCo’s controlled foreign corporation is considered a deemed dividend;
      * This deemed dividend is subject to a Part XIII withholding tax, although no penalties or interest will be payable if the withholdings are not remitted (s. 227.8(5)).
    - The PUC of the CanCo’s shares are reduced in proportion to the investment; and
    - The CanCo’s investment is not computed for s. 18(4)’s thin capitalization rules or for s. 84(1)’s deemed dividend.

**Foreign affiliate dumping — consequences**

**212.3(2)** If this subsection applies to an investment in a subject corporation made by a CRIC,

(a) for the purposes of this Part and subject to subsections (3) and (7), the CRIC is deemed to have paid to the parent, and the parent is deemed to have received from the CRIC, at the dividend time, a dividend equal to the total of all amounts each of which is the portion of the fair market value at the investment time of any property (not including shares of the capital stock of the CRIC) transferred, any obligation assumed or incurred, or any benefit otherwise conferred, by the CRIC, or of any property transferred to the CRIC which transfer results in the reduction of an amount owing to the CRIC, that can reasonably be considered to relate to the investment; and

(b) in computing the paid-up capital in respect of any class of shares of the capital stock of the CRIC at any time that is at or after the investment time, there is to be deducted the amount of any increase in the paid-up capital in respect of the class, determined without reference to this section, that can reasonably be considered to relate to the investment.

Transfer Pricing

Relevant ITA Provisions

* **Transfer pricing** addresses exchanges of value between non-arm’s length parties.
  + If transfer pricing is entirely within Canada, the CRA has no complaints, as it remains in Canada to be taxed.
    - If transfers are across provinces, each province may have some concerns.
* Part XVI.1 of the Act pertains to transfer pricing.
* Section 247(1) affords definitions.

**Definitions**

**247(1)** The definitions in this subsection apply in this section.

***arm’s length transfer price***means, in respect of a transaction, an amount that would have been a transfer price in respect of the transaction if the participants in the transaction had been dealing at arm’s length with each other.

***documentation-due date*** for a taxation year or fiscal period of a person or partnership means

(a) in the case of a person, the person’s filing-due date for the year; or

(b) in the case of a partnership, the day on or before which a return is required by section 229 of the Income Tax Regulations to be filed in respect of the period or would be required to be so filed if that section applied to the partnership

***tax benefit***has the meaning assigned by subsection 245(1).

***transfer price*** means, in respect of a transaction, an amount paid or payable or an amount received or receivable, as the case may be, by a participant in the transaction as a price, a rental, a royalty, a premium or other payment for, or for the use, production or reproduction of, property or as consideration for services (including services provided as an employee and the insurance or reinsurance of risks) as part of the transaction. (prix de transfert)

***transfer pricing income adjustment*** of a taxpayer for a taxation year means the total of all amounts each of which is the amount, if any, by which an adjustment made under subsection 247(2) (other than an adjustment included in determining a transfer pricing capital adjustment of the taxpayer for a taxation year) would result in an increase in the taxpayer’s income for the year or a decrease in a loss of the taxpayer for the year from a source if that adjustment were the only adjustment made under subsection 247(2).

***transfer pricing income setoff adjustment*** of a taxpayer for a taxation year means the total of all amounts each of which is the amount, if any, by which an adjustment made under subsection 247(2) (other than an adjustment included in determining a transfer pricing capital setoff adjustment of the taxpayer for a taxation year) would result in a decrease in the taxpayer’s income for the year or an increase in a loss of the taxpayer for the year from a source if that adjustment were the only adjustment made under subsection 247(2).

* + Arm’s length transfer price is the price that would have been agreed to at arm’s length.
  + Documentation-due date is generally synonymous with the taxpayer’s filing date.
  + Tax benefit has the same meaning as in the GAAR.
  + Transfer price is the sale price.
  + Transfer pricing income adjustment.
  + Transfer pricing income setoff adjustment pertains to where there are adjustments both ways.
* Section 247(2) raises the “**arm’s length principle**” – proper pricing should be what would be reached at arm’s length.
  + If the arm’s length principle is not met, the Minister can adjust the transfer pricing amounts.
* Section 247(3) sets out the quantum of a penalty, which follows a three-step assessment:
  + First, a **penalty threshold** is calculated as the lesser of **10%** of gross revenue, or **$5,000,000** (s. 247(3)(b)).
  + Second, a **net transfer pricing adjustment** is calculated as the difference between all positive adjustments (excluding the penalty) and all negative adjustments (made with reasonable efforts) (s. 247(3)(a)).
    - Positive adjustments include transfer pricing capital adjustments and transfer pricing income adjustments.
    - Negative adjustments include transfer pricing capital setoff adjustments and transfer pricing income setoff adjustments.
  + Third, if the net transfer pricing adjustment exceeds the penalty threshold, then the penalty is instead equal to **10%** of the net transfer pricing adjustment.
  + E.g. CanCo has gross revenues of $15 million. In its reassessments, the CRA has included an income adjustment of $5 million, and has accepted CanCo’s transfer pricing income setoff adjustment of $2 million.
    - Penalty threshold is equal to the lesser of 10% of gross revenues ($1.5 million) or $5 million – $1.5 million.
    - Net transfer pricing adjustment is equal to the difference between positive adjustments and negative adjustments – $3 million.
    - Net transfer pricing adjustment exceeds penalty threshold, meaning the penalty is equal to 10% of the net transfer pricing adjustment – $300,000.
* Section 247(4) requires tax to be paid on the additions from an adjustment, along with payments on any applicable penalties.
  + Also requires **contemporaneous documentation** (documents showing the appropriate value) to be filed with the CRA within 90 days from a request to produce documentation (s. 247(4)(c)).
    - Failure to produce documentation is akin to failing to produce evidence supporting expenses, meaning that the CRA can substitute the actual numbers with their opinion on what the numbers should be.

Contemporaneous Documentation

* Generally, transfer pricing will only concern documentation, imposition of the adjustments, and potential for penalties.
  + Typically something moreso the concern of accounting firms.
* Five general methods for determining a transfer price, ordered in priority:
  + **Comparable Uncontrollable Price (“CUP”) Method**: Compare the prices charged in a non-arm’s length transaction to a comparable transaction between independent parties in a similar market.
    - E.g. Other retailers sell widgets at a mark-up similar to what the non-arm’s length firms wish to sell at.
  + **Cost Plus Method**: Compare the profit mark-ups applied by independent parties on the cost of production of similar goods or services, in order to obtain the arm’s length sale price that should be charged by the taxpayer for goods or services.
    - Two types of mark-ups: mark-ups based on cost and mark-ups based on selling price.
  + **Resale Price Method**: Compare the profit mark-ups applied by independent parties on the sale of similar goods, in order to obtain the arm’s length purchase price that should be paid by the taxpayer to a related party in respect of the goods or services being resold to third parties.
    - Simple process for small businesses.
  + **Transactional Profit Split (“TPS”) Method:** Determine the division of profits that independent parties would have been expected to realize on a transaction, based upon functions performed, assets used, and risks assumed while engaging in similar transactions, to those entered into between related parties.
  + **Transaction Net Margin (TNM) Method:** Compare the net profit margin realized by a taxpayer from one or more transactions with related parties to the net profit margin realized by independent parties in similar circumstances.
  + The CRA believes CUP is the most persuasive evidence, and then each of the other methods in the order presented above.
* In Canada, taxpayers are required to provide contemporaneous documentation of the following:
  + Property or services to which the transaction relates;
  + Terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction;
  + The identity of the participants to the transaction and their relationship to each other at the time the transaction was entered into;
  + The functions performed, the property used or contributed, and the risks assumed;
  + The data and methods considered and analysis performed to determine the transfer prices, in respect of the transaction; and
  + The assumptions, strategies and policies, if any, that influenced the determination of the transfer prices, in respect of that transaction.

Treaty Relief

* Article IX deals with various things, but is most relevant for transfer pricing.

**Article IX**

**Related Persons**

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. The competent authorities, however, may agree to consider cases where the corresponding adjustment would not otherwise be barred by any time or procedural limitations in the other State, even if the notification is not made within the six-year period.

4. In the event that the notification referred to in paragraph 3 is not given within the time period referred to therein, and the competent authorities have not agreed to otherwise consider the case in accordance with paragraph 3(b), the competent authority of the Contracting State which has made or is to make the first-mentioned adjustment may provide relief from double taxation where appropriate.

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

* + Article IX(1) allows for adjustments on non-arm’s length transfers.
    - E.g. Widget which sold to a related person at $8 really should be sold at $10. Either contracting state can adjust that.
  + Article IX(2) is a deeming provision for relation.
    - “Management or control” – a broader test than s. 251 of the Act, which requires actual control, not just management or control.
  + Article IX(3) is a response to Article IX(1) – the state which did not make the adjustment can agree with the adjustment, and has been notified of the adjustment within six years from the adjustment.
  + Article IX(4) concerns an outcome where the adjusting state has notified the other state of the adjustment, and that other state disagrees with the adjustment, the adjusting state may choose not to adjust so as to provide relief from double taxation.
    - Both Articles IX(3) & IX(4) do not afford much power to the non-adjusting state (or to taxpayers) – they both note that the adjusting and non-adjusting state may do things or simply agree, but nothing more.
  + Article IX(5) precludes any limitation periods or limits on adjustments with fraud, wilful default or neglect, and gross negligence.

***The Queen v Irving Oil Ltd*** ([FCA 1999](https://nextcanada.westlaw.com/Document/I10b717ce5a0d63f0e0440003ba0d6c6d/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Default)&userEnteredCitation=91+DTC+5106)) – Artificial Transactions or Transactions Lacking Bona Fide Business Purposes are Not Presumptively Invalid

* Facts:
  + Irving was purchasing oil at arm’s length from Southern Oil Company of California.
  + Two corporate entities in Canada, which each owned 50% in IrvCal, in the Bermuda.
    - The two corporate entities then combined, making IrvCal a wholly owned subsidiary.
  + At the time, oil was selling at $2.24 per barrel in the USA, and then $2.90 per barrel in Canada.
  + SoCal would ship oil to Irving Oil, but would on paper sell the oil to IrvCal.
    - No (or very little) tax in the Bermuda, where IrvCal was.
  + IrvCal would then sell the oil to Irving Oil for market Canadian price - $2.90 per barrel.
    - On each barrel, the Irvings would earn $0.66.
  + The CRA applied the GAAR on the basis that this was an artificial transaction which should require the Irvings to report profit at a base cost of $2.24 rather than $2.90.
* Holdings:
  + No bona fide business purpose for IrvCal, which “was nothing more than a vehicle for tax avoidance”.
    - However, “a transaction or arrangement does not fail effectively to avoid tax simply because it lacks a bona fide business purpose” (citing Stubartand the Duke).
  + Artificiality of a transaction does not in itself determine the issue.
  + On the actual merits, essentially a comparable uncontrollable price argument – selling oil in Bermuda at fair rates, and in Canada at fair rates.
    - Same result would have been reached even if the transaction was structured differently.
    - Under today’s GAAR interpretation, likely still not abusive.
      * $2.90 a valid price in Canada; $2.24 a valid price outside of Canada.

***The Queen v GlaxoSmithKline Inc*** ([SCC 2012](https://nextcanada.westlaw.com/Document/Icc57f6bcbbd712f2e0440021280d79ee/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default))) – Soft Assets Can Increase Value; Valuation Approach Uncertain

* Facts:
  + Taxpayer produces Zantac, and sells the active ingredient of that coming off patent such that generics were considerably cheaper.
    - Taxpayer continues to sell its subsidiary the active ingredient at the higher price due to a long-term licensing agreement.
    - Generic brands come out and start using the lower price.
  + The CRA applied transfer pricing.
  + GlaxoSmith argues that the long-term licensing agreement came from a time where it was a fair price.
    - Premium for the licensee in that they could use the brand name.
* Holdings:
  + Accepted GlaxoSmith’s argument, but did not believe the supporting documents and analysis to reach the correct transfer pricing adjustment was not correct.
    - Existing license agreement justifies higher price due to the accompanying benefits – value added to the licensing agreement for the brand name – but the economic analysis was not correct.
  + Remitted the matter to the TCC to determine the appropriate economic analysis.
    - Before heard at trial, parties settled out of court, leaving no clear answer to the proper economic analysis for licensing agreements.

C: Methods to Counter Intentional Tax Evasion

Domestic Canadian Initiatives

Penalties, Offences, and Foreign Reporting

* Accounts do not deal with penalties; lawyers must, due to needing to identify risk and probable outcome.
  + For tax, generally this means that an error will result in a requirement to actually pay the tax, and to pay a penalty on top.
* Section 162(1) imposes a penalty for failure to file return on income – 5% of the tax payable that was unpaid but required to be paid.

**Failure to file return of income**

**162(1)** Every person who fails to file a return of income for a taxation year as and when required by subsection 150(1) is liable to a penalty equal to the total of

(a) an amount equal to 5% of the person’s tax payable under this Part for the year that was unpaid when the return was required to be filed, and

(b) the product obtained when 1% of the person’s tax payable under this Part for the year that was unpaid when the return was required to be filed is multiplied by the number of complete months, not exceeding 12, from the date on which the return was required to be filed to the date on which the return was filed.

* + Additional 1% penalty for each month past the late-filing, up to an additional 12% penalty for failing to file for 12 months (or more).
  + 17% penalty on the tax payable if filing a year late.
    - After a year late, no further penalty percentage, but interest continues accumulating.
* Section 162(2) imposes penalty where there has been a repeated failure to file – 10% plus 2% for every month, up to 20 months after.

**Repeated failure to file**

**162(2)** Every person

(a) who fails to file a return of income for a taxation year as and when required by subsection 150(1),

(b) to whom a demand for a return for the year has been sent under subsection 150(2), and

(c) by whom, before the time of failure, a penalty was payable under this subsection or subsection 162(1) in respect of a return of income for any of the 3 preceding taxation years

is liable to a penalty equal to the total of

(d) an amount equal to 10% of the person’s tax payable under this Part for the year that was unpaid when the return was required to be filed, and

(e) the product obtained when 2% of the person’s tax payable under this Part for the year that was unpaid when the return was required to be filed is multiplied by the number of complete months, not exceeding 20, from the date on which the return was required to be filed to the date on which the return was filed.

* + Maximum of **50%** penalty if filing 20 months or more late.
* Section 162(2.1) imposes penalties for non-resident corporations – the amount under s. 162(1) or s. 162(2), plus the greater of $100 or $25 times the number of days from which the return was required to be filed, up to **$2,500**.

**Failure to file - non-resident corporation**

**162(2.1)** Notwithstanding subsections (1) and (2), if a non-resident corporation is liable to a penalty under subsection (1) or (2) for failure to file a return of income for a taxation year, the amount of the penalty is the greater of

(a) the amount computed under subsection (1) or (2), as the case may be, and

(b) an amount equal to the greater of

(i) $100, and

(ii) $25 times the number of days, not exceeding 100, from the day on which the return was required to be filed to the day on which the return is filed.

* + Maximum penalty equal to either **17%** or **50%,** plus $2,500.
* Section 163(1) imposes a penalties for a repeated failure to report income.

**Repeated failure to report income**

**163(1)** Every person is liable to a penalty who

(a) fails to report an amount, equal to or greater than $500, required to be included in computing the person’s income in a return filed under section 150 for a taxation year (in this subsection and subsection (1.1) referred to as the unreported amount);

(b) had failed to report an amount, equal to or greater than $500, required to be included in computing the person’s income in any return filed under section 150 for any of the three preceding taxation years; and

(c) is not liable to a penalty under subsection (2) in respect of the unreported amount.

* Section 163(1.1) provides for the amount of the penalty.

**Amount of penalty**

**163(1.1)** The amount of the penalty to which the person is liable under subsection (1) is equal to the lesser of

(a) 10% of the unreported amount, and

(b) the amount determined by the formula

0.5 × (A – B)

where

A is the total of the amounts that would be determined under paragraphs (2)(a) to (g) if subsection (2) applied in respect of the unreported amount, and

B is any amount deducted or withheld under subsection 153(1) that may reasonably be considered to be in respect of the unreported amount.

* Section 163(2) applies penalties for false statements or omissions.

**False statements or omissions**

**163(2)** Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a “return”) filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of … [Calculation]

Offence Provisions

* Apply when there is culpable conduct, with the Crown holding the burden of proving that a penalty should apply, with the applicable burden being beyond a reasonable doubt.
  + A quasi-criminal offence.
* Section 238(1) is similar to the civil penalties, but also providing for a period of imprisonment of up to 12 months.

**Offences and punishment**

**238(1)** Every person who has failed to file or make a return as and when required by or under this Act or a regulation or who has failed to comply with subsection 116(3), 127(3.1) or (3.2), 147.1(7) or 153(1), any of sections 230 to 232, 244.7 and 267 or a regulation made under subsection 147.1(18) or with an order made under subsection (2) is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(a) a fine of not less than $1,000 and not more than $25,000; or

(b) both the fine described in paragraph 238(1)(a) and imprisonment for a term not exceeding 12 months.

* Section 238(3) does not allow the CRA to apply both civil and criminal penalties, unless the civil penalty was laid before the information or complaint for the criminal offence.

**Saving**

**238(3)** Where a person has been convicted under this section of failing to comply with a provision of this Act or a regulation, the person is not liable to pay a penalty imposed under section 162 or 227 for the same failure unless the person was assessed for that penalty or that penalty was demanded from the person before the information or complaint giving rise to the conviction was laid or made.

* + As soon as the CRA suspects that the conduct investigated was done intentionally with mens rea sufficient to bring the matter into a criminal offence, the CRA must either tell the taxpayer that the matter is moving to criminal, or drop the matter.
    - In comparison, where the CRA is administering a civil audit, taxpayers are required to comply and assist the CRA with their civil investigation.
      * That obligation ceases as soon as a criminal investigation begins; also puts a pause to the CRA’s extensive civil search powers.
  + Any time that a reassessment is issued, and a taxpayer does not reply, they are liable, and potentially for penalties on top of that.
  + A conviction under s. 238(1)(a) requires the Crown to establish mens rea (R v Jarvis (BCPC 1971)).
* Section 239(1) sets out additional offences:

**Other offences and punishment**

**239(1)** Every person who has

(a) made, or participated in, assented to or acquiesced in the making of, false or deceptive statements in a return, certificate, statement or answer filed or made as required by or under this Act or a regulation,

(b) to evade payment of a tax imposed by this Act, destroyed, altered, mutilated, secreted or otherwise disposed of the records or books of account of a taxpayer,

(c) made, or assented to or acquiesced in the making of, false or deceptive entries, or omitted, or assented to or acquiesced in the omission, to enter a material particular, in records or books of account of a taxpayer,

(d) wilfully, in any manner, evaded or attempted to evade compliance with this Act or payment of taxes imposed by this Act, or

(e) conspired with any person to commit an offence described in paragraphs 239(1)(a) to 239(1)(d),

is guilty of an offence and, in addition to any penalty otherwise provided, is liable on summary conviction to

(f) a fine of not less than 50%, and not more than 200%, of the amount of the tax that was sought to be evaded, or

(g) both the fine described in paragraph 239(1)(f) and imprisonment for a term not exceeding 2 years.

* Section 239(2) allows for prosecution on indictment for the offences under s. 239(1):

**Prosecution on indictment**

**239(2)** Every person who is charged with an offence described in subsection 239(1) or 239(1.1) may, at the election of the Attorney General of Canada, be prosecuted on indictment and, if convicted, is, in addition to any penalty otherwise provided, liable to

(a) a fine of not less than 100% and not more than 200% of

(i) where the offence is described in subsection 239(1), the amount of the tax that was sought to be evaded, and

(ii) where the offence is described in subsection 239(1.1), the amount by which the amount of the refund or credit obtained or claimed exceeds the amount, if any, of the refund or credit to which the person or other person, as the case may be, is entitled; and

(b) imprisonment for a term not exceeding 5 years.

* Sections 233.1(2) & 233.1(4) together impose the offence and a de minimis exception for filing of transactions.

**Reporting person’s information return**

**233.1(2)** Subject to subsection 233.1(4), a reporting person for a taxation year shall, on or before the reporting person’s filing-due date for the year, file with the Minister, in respect of each non-resident person with whom the reporting person does not deal at arm’s length in the year and each partnership of which such a non-resident person is a member, an information return for the year in prescribed form containing prescribed information in respect of the reportable transactions in which the reporting person and the non-resident person or the partnership, as the case may be, participated in the year.

**De minimis exception**

**233.1(4)** A reporting person or partnership that, but for this subsection, would be required under subsection 233.1(2) or 233.1(3) to file an information return for a taxation year or fiscal period is not required to file the return unless the total of all amounts, each of which is the total fair market value of the property or services that relate to a reportable transaction in which the reporting person or partnership and any non-resident person with whom the reporting person or partnership, or a member of the reporting partnership, does not deal at arm’s length in the year or period, or a partnership of which such a non-resident person is a member, as the case may be, participated in the year or period, exceeds $1,000,000.

* + Taxpayers must report any transactions they have carried out with non-arm’s length non-residents, unless the value of the transactions is less than **$1,000,000** – a **de minimis rule**.
* Section 233.3 provides similarly, but for foreign property.

**Returns respecting foreign property**

**233.3(3)** A reporting entity for a taxation year or fiscal period shall file with the Minister for the year or period a return in prescribed form on or before the day that is

(a) where the entity is a partnership, the day on or before which a return is required by section 229 of the Income Tax Regulations to be filed in respect of the fiscal period of the partnership or would be required to be so filed if that section applied to the partnership; and

(b) where the entity is not a partnership, the entity’s filing-due date for the year.

* Section 162(10) provides the calculation for a penalty for failure to furnish foreign-based information.

**Failure to furnish foreign-based information**

**162(10)** Every person or partnership who,

(a) knowingly or under circumstances amounting to gross negligence, fails to file an information return as and when required by any of sections 233.1 to 233.4 and 233.8, or

(b) where paragraph 162(10)(a) does not apply, knowingly or under circumstances amounting to gross negligence, fails to comply with a demand under section 233 to file a return

is liable to a penalty equal to the amount determined by the formula

($500 × A × B) - C

where

A is

(c) where paragraph 162(10)(a) applies, the lesser of 24 and the number of months, beginning with the month in which the return was required to be filed, during any part of which the return has not been filed, and

(d) where paragraph 162(10)(b) applies, the lesser of 24 and the number of months, beginning with the month in which the demand was served, during any part of which the return has not been filed,

B is

(e) where the person or partnership has failed to comply with a demand under section 233 to file a return, 2, and

(f) in any other case, 1, and

C is the penalty to which the person or partnership is liable under subsection 162(7) in respect of the return.

* Section 152(4) allows for the Minister to assess and reassess for these purposes.

**Assessment and reassessment**

**152(4)** The Minister may at any time make an assessment, reassessment or additional assessment of tax for a taxation year, interest or penalties, if any, payable under this Part by a taxpayer or notify in writing any person by whom a return of income for a taxation year has been filed that no tax is payable for the year, except that an assessment, reassessment or additional assessment may be made after the taxpayer’s normal reassessment period in respect of the year only if

…

(b.2) the assessment, reassessment or additional assessment is made before the day that is three years after the end of the normal reassessment period for the taxpayer in respect of the year and if

(i) the taxpayer, or a partnership of which the taxpayer is a member, has failed to file for the year a prescribed form as and when required under subsection 233.3(3) or to report on the prescribed form the information required in respect of a specified foreign property (as defined in subsection 233.3(1)) held by the taxpayer at any time during the year, and

(ii) the taxpayer has failed to report, in the return of income for the year, an amount in respect of a specified foreign property that is required to be included in computing the taxpayer’s income for the year;

* The offshore tax informant program allows informants to enter into a contract that will end in a reward, under which the informant discloses relevant information on failures to report foreign property or other tax evasion.

International Initiatives

Base Erosion Profit Shifting (BEPS)

* **Base erosion profit shifting** (BEPS) is an initiative by the OECD aimed at combatting international tax evasion.
  + Most major companies do not actually evade and avoid tax, but aggressively pursue tax litigation and strategies which result in a reduction of tax payable – evading tax legally.
  + Many companies were treaty shopping to legally minimize their tax liability.
  + BEPS is a list of recommendations, and countries can sign on using the multi-lateral instrument.
    - Instead of re-negotiating each treaty, countries sign on through the instrument and note which recommendations they intend to adopt.
      * Any country the signing corporation has a treaty with will be captured by the MLI.
        + The MLI would be dissolved in the event that a treaty is re-negotiated.
  + E.g. $100,000 taxable income is the “base”, and anything done to reduce that is the erosion.
    - Profit shifting is the shift of profits, legally, to another jurisdiction such that less tax is paid.
* Final draft of BEPS was released on 5 October 2015, with fifteen recommendations, listed in the order of priority:
  + Digital economy.
    - E.g. Walking into a store and using an iPad in store to purchase a product, with the product then being shipped to the consumer’s residence.
      * Server management, commission and processing for credit card fees, consumer’s address, physical warehouses, processing of order, manufacturing site for the product, etc.
        + Each could be in different countries – how should it possibly be taxed?
  + Hybrid mismatch arrangements.
    - Arrangements where one entity is treated for tax purposes differently in one country compared to another.
      * E.g. ULC’s in Canada are considered corporations and subject to corporate tax, while in the US they are considered to be a flow-through entity.
      * A CanCoULC has profit and interest deductions in Canada such that its taxable income is $0.
      * Say the USCo which owns the CanCo owes debt to the CanCo, and earns interest on that.
        + The USCo is allowed to deduct the interest from its own income.
        + There will be a flow-through of profit to the USCo, which already accounted for the interest deduction.
        + Net result is that there is two deductions from interest; this mischief has since been addressed.
  + Controlled foreign companies.
    - Addressing corporations controlled by non-resident corporations.
  + Financial payments dealing with interest and dividends.
  + Harmful tax practices.
  + Treaty abuse.
    - E.g. US introducing treaty abuse legislation – Article 29: Limitation on Benefits.
      * Canada has the GAAR, which following the amendments to the Income Tax Interpretation Act (and the GAAR) is clearly applicable to treaties.
  + Artificial avoidance of permanent establishment status.
  + Transfer pricing.
  + Measuring and monitoring BEPS.
  + Mandatory disclosure rules.
  + Transfer pricing documentation.
  + Dispute resolution mechanisms.
  + Multilateral conventions.