Double Residents, Effect of tie breaker rules - Sas Ansari

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Double Residents - What is the effect of resident tie breaker rules in tax conventions?

Black v The Queen, 2014 TCC 12

[The FCA upheld this decision in *Black v Canada*, 2014 FCA 275]

In this case the Court was faced with the need to determine the domestic effect of the treaty tie breaker rules in the Canada-UK tax convention. Conrad Black believed that he had arranged his affairs such that by interaction of the Convention with the domestic tax rules, he would able to enjoy double non-taxation on his non-Canadian source income that was not received or remitted to the UK. He was wrong.

The TCC interpreted the treaty tie breaker rules to determine residency only for purposes of the Tax Treaty, with no effect on the residency status of the taxpayer for purposes of the Canadian ITA. Thus, a taxpayer can be a resident of one contracting state for purposes of the treaty, and resident of the other contracting state for purposes of that other state's domestic tax laws. This circumstance would only give rise to a conflict resulting in the override of the domestic tax law where there was double taxation or a denial of a treaty benefit (conflict or incompatibility). In this case, the foreign source income not taxable in the UK was taxable in Canada, as the taxpayer was a resident of Canada. Also, absent an "other income" article in a tax treaty, Canada would be able to tax all income items not specifically covered in the treaty.

 ISSUES

This was an application for a determination under the *Tax Court of Canada Rules, (General Procedure),* section 58. The issue was whether in light of the tax treaty with the UK, Canada could assess Conrad Black tax under the ITA on the basis that Mr Black was a Canadian resident. Specifically:

1. Whether a determination of UK residence under article 4(2) for purposes of the convention overrides the ITA to prevent the CRA from assessing tax on certain items as a resident of Canada for purposes of the ITA? and
2. Whether article 27(2) of the treaty applies to allow the CRA to assess the applicant as a resident of Canada for the items assessed?

FACTS

The applicant was both a resident of Canada and of the UK in 2002, and resorted to the tie

breaker rules found in Article 4 of the Canada-UK treaty. By application of paragraph (a) of Article 4(2) of the treaty, the applicant was held to be a resident of the UK. Canada assessed tax on certain items on the basis that the applicant was a resident of Canada "for purposes of the Act" in 2002.

The applicant was assessed under Part I of the ITA for (a) incomes from the duties of offices or employments performed by the applicant outside of Canada; (b) various shareholder and employee benefits received; (c) taxable dividend received; (d) interest and other investment income received; (e) benefit received pursuant to ITA 15(1),(9), and 80.4(2) in respect of indebtedness owed.

Since the applicant was resident but not domiciled in the UK, he was taxable in the UK only on such portion of his UK source income remitted or received in the UK. None of the items (save the income from duties) was taxable in the UK. The income from duties was taxable in the UK if performed in the UK even if not received or remitted in the UK, but duties performed in the US were not taxable in the UK unless received or remitted into the UK.

In respect of Canada, income received from duties performed in Canada are taxable in Canada whether the applicant was a resident or a non-resident (s 115(1)(a)(i)). If the taxpayer was a resident of Canada for purposes of the ITA, the Canada could tax income from duties of office or employment performed outside of the UK, and the other items assessed.

ARGUMENTS

The applicant argued that he could not be a resident of the UK for purposes of the Convention and a resident of Canada for purposes of the ITA, as this would ignore provisions of the Convention and defeat its purpose of avoiding double taxation.

The applicant also argued that Article 27 of the convention did not apply to give Canada the power to tax the incomes assessed. Article 27 applies only to limit the lower withholding rates in the convention in Articles 10, 11, and 12 that relate to dividends, interest, and royalties. Since the applicant was a UK resident by virtue of the tie-breaker rules, there was no tax in Canada from which the applicant was relieved under any provision of the Convention, thus article 27 could not come into play.

The MNR argued that Article 4(2) deems the applicant to be a resident of the UK for convention purposes only, and does not affect the domestic law concept of residence. The effect of the convention, when applicable to a resident of Canada, is to allow either a deduction from income for the amount if the income is exempt, or claim a reduced rate of income tax if provided by the convention.

The MNR stated that Article 27 operates such that where Canada provides any relief from taxation on certain income under any provision of the convention, any income not subject to tax in the UK by reference to the amount that is remitted or received I the UK, is subject to tax in Canada.

ANALYSIS

The court notes that if the applicant is correct, then he is not liable to tax in any country on any of the items unless and until he remits or receives them in the UK. The Court notes that here there is a flaw in the drafting of the Convention or the ITA that allows for double non-taxation, it is not the court's role to remedy the flaw.

In interpreting the relevant articles of the Canada-UK convention, the TCC referred to: (1) Article 31(1) of the *Vienna Convention on the Law of Treaties* – treaty to be interpreted in good faith and in light of its object and purpose; (2) *The Queen v Crown Forest Industries Limited et al*, [1995] 2 S.C.R. 802 - the paramount goal of finding the meaning of the words in a treaty involves taking a liberal and purposive approach by looking at the language as used and the intention of the parties, and extrinsic materials used to illustrate and illuminate the parties' intentions; and (3) *Swathe v R*, 1994 CarswellNat 1020 (FCA) – interpretation of a treaty must be a functional one where the whole scheme is considered in light of its intent, object, and spirit.

The TCC turned its mind to Article 4, and stated that the purpose of the convention is to avoid double taxation, but that in Canada a tax treaty's purpose today is "the allocation of the taxing power between the country of the income's source and the taxpayer's country of residence" (para 23). If there is a conflict between the applicant being a resident of the UK for purposes of the convention and a resident of Canada for purposes of the ITA, then by virtue of subsection 30(2) of the *Convention Act* the convention will prevail. However, since the convention states that the person is a resident for the purpose of the convention itself and nothing else, there is no inconsistency. "Article 4 determine whether or not a taxpayer who is a resident of Canada and the UK is eligible for relief under the convention as a resident of either the UK or Canada" (para 27).

The TCC stated that to hold that a person deemed to be a resident of the UK for purpose of the convention is therefore a non-resident of Canada for purpose of the ITA is wrong and reflects a mechanical approach to interpreting the convention and goes beyond the convention's intention. The Court referred to *Friends of the Oldman River Society*, [1992] 1 S.C.R. 3, and stated that to be inconsistent two provisions must be either contradictory or unable to stand together. The court also referred to the commentary of the OECD model treaty, and concluded that the tie breaker rules only give preference or priority of claim to one of the two contracting states (para 33). The domestic law of neither country is overridden, and neither countries claim is extinguished. The OECD Model Convention preliminary remarks also make it clear that the concept of "resident of a Contracting state" serve the purpose of solving cases where double taxation arises in consequence of double residence (para 43).

The TCC noted that the applicant could not point to any operative articles of the convention that would be contravened by him being a resident of Canada for ITA purposes, that there is no double taxation, and that if the income is eventually remitted to the UK the taxpayer could make use of Article 21 of the convention. The court concluded:

> [51] Article 4(2) provides preference criteria for instances where a taxpayer is a resident of both contracting states. These tiebreaker rules deem a dual resident to be a

> resident of either Canada or the U.K. for the purposes of the *Convention*. Once a taxpayer is a resident of either the U.K. or Canada for the purposes of the *Convention*, the other Articles of the *Convention* operate to relieve taxation and allocate taxing authority. That is what the *Convention* does: it allocates to each country the authority to tax. That a person is resident of the U.K. for *Convention* purposes does not affect his or her status under Canadian law for non?treaty purposes
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> [52] As respondent's counsel stated, Canada is required by international law to implement the substance of the provisions of the Convention. To respect its obligation, Canada need not treat the applicant as a non?resident of Canada for the purposes of the Act. Canada's responsibility is to insure that the applicant can obtain relief from Canadian taxation to which he is entitled under the *Convention*.
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> [53] In summary, a liberal and purposive approach must be adopted when interpreting tax treaties, not a mechanical approach. I must look to the plain language of the treaty and to the intent of the parties. When looking for an inconsistency between the Act and a tax convention, it is the results that should be examined. An inconsistency only occurs if the result of the application of the Act is in contradiction with, or in violation of, the purposes of the *Convention* and I have not found this to be.

The Court did not need to do so, but addressed the relevance of Article 27(2) of the Convention, which addressed the UK tax treatment of non-domiciled residents of the UK who are required to pay tax on foreign income only when it is remitted or received in the UK. This article only operates to provide treaty relief for items actually taxable in the UK. Also, unlike to other conventions that Canada is a party to, the UK convention does not limit the Canadian income taxation of non-Canadian source income of Canadian residents who are also resident of the UK.

A tax treaty determines the tax treatment of income on an item by item basis. If a treaty does not contain a “other income” provision, then countries where the taxpayer are resident retain the right to tax that taxpayer on that item of income. The “other income” Article for the UK-Canada Tax treaty, Article 20(A), was added later and does not apply to the 2002 tax year. Therefore, for the 2002 tax year, income items not specifically dealt with in the treaty were taxable by Canada in the same manner as any other resident of Canada would be taxable on those items.

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