Maximum Tax Credit Under Income Tax Treaties - Sas Ansari

Author : admin

Maximum Tax Credit Under Income Tax Treaties

Société générale valeurs mobilières inc. v. The Queen, 2016 TCC 131

This was a Rule 58 application to determine whether the maximum tax credit Canada is liable to grant under the Canada-Brazil tax treaty, referred to by the words "[t]he deduction shall not, however, exceed that part of the income tax as computed before the deduction is given, which is appropriate to the income which may be taxed in Brazil" is calculated on the basis of net or gross income from Brazil. In other words, do the expenses incurred to earn the income have to be taken into account in determining the Canadian tax otherwise payable as a reference point for the maximum credit?

ANALYSIS

The interpretation of treaties is governed by the *Vienna Convention on the Law of Treaties*. Canada is a signatory to this convention. Article 31(1) provides that "A treaty shall by interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its objects and purpose". Further, the Income Tax Conventions Interpretation Act, section 3 provides that an undefined term in a treaty has the same meaning as it has for purposes of the *Income Tax Act*, unless the context otherwise requires. The ITA meaning is not that at the time of the making of the treaty, but the meaning as amended from time to time. The Supreme Court of Canada stated that the goal of interpreting a treaty is finding "the meaning of the words in question. This process involves looking to the language used and the intention of the parties" - *Crown Forest Industries Ltd.v. Canada*, [1995] 2 S.C.R. 802*, at para. 22*.

The parties agreed to the meaning of portions of the sentence in dispute:

- "income tax as computed before the deduction is given" means the taxpayer's Canadian income tax computed before the foreign tax credit is applied; and
- "income which may be taxed in Brazil" is a reference to the income Brazil is entitled to tax under the treaty.

The Court considered the English, French, and Portuguese versions of the treaty. Each language version is equally authoritative and they all are held to have the same meaning. The

TCC held that the meaning of "appropriate" in this case refers to a correspondence or logical connection between that part of the Canadian tax to be allowed as a credit and the Brazilian bond income (para 31). The steps to be followed in determining the maximum tax credit are:

- Compute the Canadian income tax payable by the taxpayer before the foreign tax credit is given;
  - The computation of Canadian income tax otherwise payable is according to the *Income Tax Act*;
- Identify what portion of the Canadian income tax computed relates to the Brazilian income.

The foreign tax credit amount is limited to the actual Canadian tax the taxpayer would otherwise pay on the foreign income (para 34). Where the Canadian tax under the *Income Tax Act* is on a net basis, the tax otherwise payable is also determined by taking into account deductible expenses.

The Court distinguished the gross basis income decisions of the Supreme Court of Canada in *Interprovincial Pipe Line Company v. MNR*, [1959] S.C.R. 763, decided in 1959 and *Interprovincial Pipe Line Company v. MNR,* [1968] S.C.R. 498, because at that time the ITA did not require taxpayers to compute their income from different sources separately. The ITA was amended after that to provide that a taxpayer's income from each source was to be calculated on a separate basis and that deductions, where reasonably applicable to such sources, were assumed to have been computed in computing the income from that source - See ITA subsection 4(1). Subsection 4(1) sets out the test for determining which expense is relevant to income from a source in a particular place.

The Court recognized that this treaty contained a tax sparing provisions, but did not agree that the tax sparing provisions was meant to allow for a Canadian tax credit in excess of the taxes otherwise payable on the Brazilian source income. The maximum tax deemed paid by on the income is determined by the tax sparing provision. However, the tax credit in Canada is limited by the income tax otherwise payable on that income according to Canadian rules. This way, the tax incentives offered in Brazil are not impacted by Canada taxing the amount of income subject to the incentive.

This interpretation is also supported by the OECD Model Convention and its Commentaries. The credit is for the Canadian taxes actually paid and not credit for all of the Brazilian taxes paid or deemed paid (para 63).

Sas Ansari, BSc BEd PC JD LLM PhD (exp) CPA In-Depth Tax 1, 2 &3

If you like this website, please share it with others.

Back To Top OR Home

medianet_width = "160"; medianet_height = "90"; medianet_crid = "749795932"; medianet_versionId = "111299"; (function() { var isSSL = 'https:' == document.location.protocol;