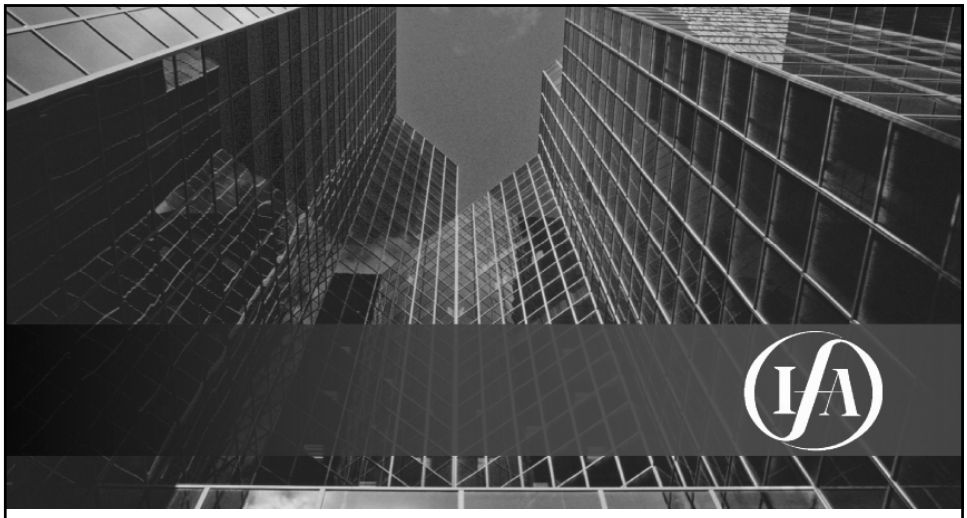

Residence of Individuals, Companies and Trusts:

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Individual Residence

Individual Residence

- Subsection 2(1) – worldwide taxation if resident
  - Highly factual
- Subsection 250(1) – deemed residence
  - Sojourners, diplomats, forces personnel, etc.
- Subsection 250(3) – ordinarily resident
- Subsection 250(5) – treaty residence
  - Tie-breaker rules

Individual Residence

- *Lingle* (2009 TCC, Cambpell J.)
  - Meaning of “habitual abode” in Canada-US Treaty tie-breaker rule
- Tie-breaker hierarchy (Art. IV(2)
  - Availability of permanent home; if neither or both then…
  - Centre of vital interests; if undeterminable, then…
  - Habitual abode; if neither or both, then…
  - Citizenship; if neither or both, then…
  - Competent Authority

Individual Residence – *Lingle*

- US citizen working in Canada
- Home in Canada (girlfriend)
- Home in the US (spouse and children; separated and later divorced)
- Approximately one weekend per month in the US (69 days out of 623)

Individual Residence - *Lingle*

- Statement of agreed facts:
  - permanent home available in each country
  - not possible to determine “centre of vital interests”
  - home in Canada was an “habitual abode”
- Issue: Is home in the US an “habitual abode” such that citizenship would govern?

Individual Residence - *Lingle*

- Campbell J. rejects frequency of stay as being the sole factor in determining habitual abode
  - This approach was adopted by the Tax Court in *Allchin* (2005)
- Any ambiguity in meaning of "habitual abode" eliminated in French version: "*où elle se séjourne de façon habituelle*"

Individual Residence - *Lingle*

- An habitual abode is somewhere a person regularly, customarily or normally lives.
- Mr. Lingle's stays in the United States did not rise to the level of "habitual" – he did not regularly, customarily or normally live in the US.

Individual Residence – Discussion Points

Foundations for Individual Residence

- One of the most fundamental questions in tax design is over which individuals the state will assert taxing jurisdiction in imposing tax on worldwide income
- Three most common options: political allegiance, choice, and economic allegiance

Individual Residence – Discussion Points

- The legal concept of residence captures this last justification – we tax individuals on their worldwide income when they have sufficient economic nexis here
- Article 4(2) deals with the problem of dual residence – individual have sufficient economic connections to be taxed in more than one country

Individual Residence – Discussion Points

- Generally in Canada's treaties the tie-breaker list is designed to identify a rank-order of types of connection to Canada by significance
- The list provides some bright lines on important indicators of social and economic connection

Individual Residence – Discussion Points

Canadian views on habitual abode

- Habitual abode has often been considered to require a relatively straightforward consideration of the amount of time spent in one country rather than the other alongside considerations of where the taxpayer has his or her lifestyle and activities
- Three recent Canadian decisions
- *Allchin v. R (2005)* – the court concluded that the taxpayer's habitual abode was in the United States on the basis that her lifestyle and activities were predominantly in that country and because she spent about 265 days a year in the United States and only about 100 days a year in Canada.

Individual Residence – Discussion Points

- Second, the court considered, in obiter, the application of the habitual abode test in *Yoon v. R (2005)*. The taxpayer was held not to be a resident of Canada under the common law tests for residence. Nevertheless, the judge considered the application of the tie-breaker rules in the Canada–Korean treaty and concluded that the main issue is where the taxpayer stayed more frequently. In that case, she spent 224 days in Korea and 135 days in Canada leading to the conclusion that her habitual abode was in Korea.
- *Lingle* clearly rejects frequency of stay as a sole factor

Individual Residence – Discussion Points

Summary of Canada's approach to tie-breaker ordering in tax treaties

- In a few tax treaties the standard list of tie-breaker rules has not been adopted.
- In the Canada–US treaty, the first step of the tie-breaker rule considers whether the taxpayer has a permanent home available in both states or neither, rather than considering whether the taxpayer has a permanent home in both states in the first step and moving the assessment of whether he or she lacks a permanent home in both to the third stage of the inquiry.

Individual Residence – Discussion Points

- Second, in several treaties the use of the nationality test is replaced with citizenship.
- Third, in Canada's treaty with Papua New Guinea, the tie-breaker order is adjusted (habitual abode is considered before centre of vital interests).
- Fourth, in several treaties the number of tie-breaker factors is reduced. For example, Canada's tax treaty with Australia looks only to where the individual has a permanent home and location of his or her personal and economic relations.

Corporate Residence

Corporate Residency - Background

- Subsections 250(4) to (6) contain deeming rules that apply in certain circumstances (e.g. where a corporation is incorporated in Canada or is resident in another jurisdiction for purposes of a tax treaty).
- At common law, a corporation is resident in the jurisdiction in which its central management and control actually abides (*De Beers Consolidated Mines Ltd.*).
- In general, central management and control will be found to be in the jurisdiction where the corporation's directors meet and make key decisions.
- Except in exceptional circumstances, the role of controlling shareholders has not been relevant.

Wood v. Holden

- Taxpayers owned 96% of the shares of a corporation ("Greetings") that operated a chain of card shops.
- Price Waterhouse ("PW") developed a plan that would avoid capital gains tax on an indirect sale of the shares of Greetings.
- Several corporations, indirectly controlled by the taxpayers, undertook a complex series of transactions in order to dispose of shares of a corporation ("Holdings"), which acquired the shares of Greetings as part of the series of transactions, without attracting UK capital gains tax.

Wood v. Holden

- CIL, a BVI corporation, acquired the shares of Holdings by way of gift and purchased a dormant Netherlands subsidiary ("Eulalia"). A Netherlands trust company was appointed as managing director of Eulalia. Five days later at a meeting in the Netherlands, the purchase of the Holdings shares from CIL was approved by Eulalia.
- Eulalia then retained PW to advise it on subsequent sale of Holdings shares. Proposed structuring and draft documents were provided to the managing director.
- Taxpayers subject to UK tax on the gain realized by CIL on its disposition of Holdings if Eulalia was resident in the UK at the time of the disposition and under the Netherlands-UK treaty, the UK was its place of effective management ("POEM").

Wood v. Holden – Special Commissioners

- Special Commissioners concluded that the taxpayers had failed to establish that Eulalia was not resident in the UK stating:

> The only acts of management and control of [Eulalia] were the making of the board resolutions and the signing or execution of documents in accordance with those resolutions. We do not consider that the mere physical acts of signing resolutions or documents suffice for actual management. Nor does the mental process which precedes the physical act. What is needed is an effective decision as to whether or not the resolution should be passed and the documents signed or executed and such decisions require some minimum level of information.

Wood v. Holden – Court of Appeal

- Decision of the Special Commissioners was overturned by the Chancery Division. Taxpayer also lost at Court of Appeal.
- Distinguished between "cases where management and control of the company is exercised through its own constitutional organs … and cases where the functions of those constitutional organs are 'usurped' – in the sense that management and control is exercised independently of, or without regard to, those constitutional organs".

Laerstate BV (2009, UKFTT)

- Taxpayer was a Netherlands company that owned shares of a British company ("Lonrho").
- Sole shareholder of the taxpayer was a UK resident ("Bock") and initially its only director was an individual resident in the Netherlands ("Trapman").
- All transactions relating to the acquisition of the Lonrho shares took place in London on the instructions of Bock before he became a director. Certain documents signed by Trapman described the transactions incorrectly.

Laerstate - Facts

- Bock moved to the UK and became a director of the taxpayer. Several years later, a strategy for disposing of the Lonrho shares was developed by Bock in the UK and correspondence indicated that Bock gave the instructions to the lawyers.
- The taxpayer received an offer to purchase its Lonrho shares, which was sent to Bock in UK. The offer was discussed at a meeting in Zurich which both Bock and Trapman attended. Following the meeting, Bock made changes without Trapman's involvement. After a period of negotiations, the taxpayer accepted the offer.
- Bock resigned as a director of the taxpayer in August and the sale was completed in November.

Laerstate - Issues

- UK tax authorities assessed the taxpayer for tax on the gain realized on its disposition of its Lonrho shares on the basis that it was resident in the UK at the time of the disposition.
- First issue was whether the taxpayer was resident in the UK on the basis that Bock exercised central management and control of the taxpayer from the UK.
- Second issue was the taxpayer's "POEM" – tie breaker test under the Netherlands-UK Treaty.

Laerstate - Reasons

- Taxpayer held to be resident in the UK.
- Location of directors' meetings is determinative only where management of the corporation in fact occurs at such meetings.
- Majority shareholder free to indicate how directors should act, provided directors still make the decision.
- Four categories of directors' involvement.

Laerstate – Reasons

- Directors sign resolutions when directed to do so without reviewing or understanding them.
- Directors sign resolutions when directed to do so with knowledge of what they are signing, but without obtaining the minimum information required to decide whether it is advisable to sign.
- Directors sign resolutions when directed to do so with knowledge of what they are signing and after obtaining the minimum information required to decide whether it is advisable to sign.
- Directors decide whether to sign resolutions on the basis of full information and following independent consideration.

Laerstate – Reasons

- While Bock was a director, the taxpayer held to be resident in the UK on the basis that policy, strategic and management matters took place in the UK.
- After Bock ceased to be a director, the taxpayer was held to be resident in the UK on the basis that Trapman signed documents without considering them and without minimum information.
- POEM found to be in UK.
- *Laerstate* has been appealed to the UK Upper Tribunal and is scheduled to be heard on June 7-9, 2010.

Wood v. Holden—Discussion Points

- Recent UK cases have made corporate residence hot topic—statements by HMRC Director General suggest more to come (in addition to *Laerstate* and *Smallwood* appeals), especially in relation to corporate migrations
- Focus in cases is how to apply *Unit Construction* exception—have normal board functions been displaced or usurped by controlling shareholder (or its managers or advisers) acting somewhere else

Wood v. Holden—Discussion Points

- In *Wood v. Holden,* Court held board authority not displaced or usurped where board decisions not dictated by others—not fatal that controlling shareholder (or managers or advisers) exercised significant influence on board decisions (in Canada, see *Zehnder and Company*)
- Notwithstanding strong influence of others, board would have refused to carry out improper or unwise decision—although unclear how a court satisfies itself on this hypothetical

Wood v. Holden—Discussion Points

- Nature and place of board's decisions more important than its motivation
- Where nature of business limited (i.e., a subsidiary holding corporation)—not fatal if board decisions thereby limited or if no independent consideration of parent-subsidiary transactions
- Not fatal board might have concluded differently based on more information—"ill-informed decisions" of board remain board decisions

Laerstate—Discussion Points

- *Laerstate* difficult read—to some, it restates central management and control test because Tribunal determined that "real management" not exercised by board without "independent consideration" based on "minimum information"
- Case confirms central management and control located at place where board regularly meets only if board exercises "real management" at such meetings—where it does not, board displaced or usurped

Laerstate—Discussion Points

- Board signed documents without considering whether it would be better to sign or not, without even minimum information—in some cases, without even thinking what documents were—in Tribunal's view, without minimum information board not making any decision at all
- Where Tribunal drew line in matrix (slide 26) contrary to *Wood v. Holden* and *Untelrab* where board determined to have made decision even though it simply followed advice and wishes of controlling shareholder (and advisers)—no requirement for minimum information or independent consideration
- Tribunal seems to adopt "independent consideration" and "minimum information" standards advocated by IRC and rejected in *Wood v. Holden*

Laerstate—Discussion Points

- *Laerstate* illustrates taxpayer has onus in residence cases and relevant books and records—including personal time diaries, travel documents, email and other internal letters and memorandum may be fertile ground for assertion by tax authority that board did not exercise real management of business
- In that connection, note case heard in 2009 but involved 1992-1996 events

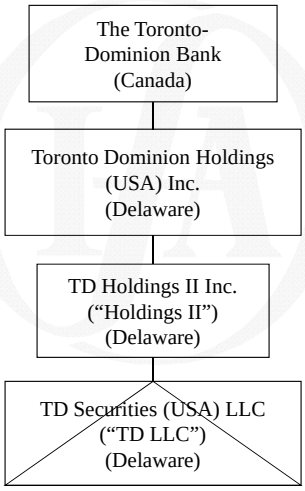
Treaty Residency - Background

- Article IV of the Canada-US Tax Treaty defines a resident of a contracting state to be a person liable to tax therein by reason of certain enumerated criteria.
- SCC held in *Crown Forest* (1995) that, in order for a person to be a resident of the US for purposes of the Canada-US Treaty, the person must be liable to tax on its worldwide income.
- CRA's position has been that a US LLC is not a "resident" of the US for purposes of the Canada-US Treaty since if it is fiscally transparent for US tax purposes it is not liable to entity-level US tax.

Residency of Hybrid Entities

:

TD Securities (USA) LLC, 2010 TCC 186



TD Securities - Facts

- TD LLC was a registered US broker-dealer carrying on business in the US, with branch operations in Canada.
- All of TD LLC's income was included in the income of Holdings II (as income from a branch) for US tax purposes.
- TD LLC paid Part XIV tax on its Canadian branch profits for 2005 and 2006 at a reduced rate of 5%, claiming it was entitled to benefits under the Canada-US Treaty.
- CRA assessed TD LLC for Part XIV tax computed at the full 25% rate, concluding that TD LLC was not entitled to the benefit of the 5% rate under the Canada-US Treaty.

TD Securities - Issue

- Issue was whether TD LLC was a resident of the US under Article IV of the Canada-US Treaty.
- TD LLC argued that the phrase “liable to tax” is not simply a determination of whether a person is required to pay tax on its income and that it was “liable to tax” on the basis that its sole member (Holdings II) was a resident of the US and was subject to US tax on TD LLC’s income on a comprehensive basis.
- (Fifth Protocol not applicable)

TD Securities – Decision

- Tax Court of Canada (per Boyle J.) held that TD LLC was a resident of the US under Article IV(1) of the Canada-US Treaty since:
  - TD LLC was liable to tax in the US “by virtue of all of its income being fully and comprehensively taxed under the US Code albeit at the member level” (para. 101); and
  - the income of TD LLC was subject to tax in the US by reason of the place of incorporation of its member, which is a ground similar to those enumerated in Article IV(1) (*i.e.*, domicile, residence, citizenship, place of management and place of incorporation).

TD Securities – Reasons

- Boyle J set out the overarching interpretive principle that Treaties should be interpreted in context, and in accordance with their purpose and the intentions of the parties. Where a literal interpretation leads to an unreasonable result, regard should be had to extrinsic materials.
- Relied on OECD materials to ascertain the interpretative principles applicable to partnerships and concluded that they should also apply to fiscally transparent LLC's – treaty benefits apply to income of a partnership which is not treated as fiscally transparent by the source state, even though the partnership is fiscally transparent in the home state.

TD Securities – Reasons

- Reviewed CRA's interpretative approach to Article IV – that partners of a partnership, S Corps, not-for-profit corporations and pension funds were entitled to treaty benefits notwithstanding interpretative issues. Concluded CRA had adopted an anomalous approach with respect to LLCs.
- "Overwhelming consistency of Canadian government's approach" to FTE's leads to the conclusion that it was not intended that treaty benefits would not apply to income of an entity that is fully and comprehensively taxed in the other contracting state.

TD Securities - Ratio

- "The decision in this case stands for no more than the proposition that, properly interpreted and applied in context in a manner to achieve its intended object and purpose, the US Treaty's favourable tax rate reductions apply for years prior to the Fifth Protocol Amendments to the Canadian-sourced income of a US LLC if all of that income is fully and comprehensively taxed by the US to the members of the LLC resident in the US on the same basis as had the income been earned directly by those members." (para. 107)

TD Securities – Qualifications

- Boyle J stated that his analysis was subject to several qualifications:
  - Analysis does not apply to Canada-US Treaty as amended and revised by Fifth Protocol (para. 103)
  - Neither abusive tax avoidance nor treaty abuse was argued or considered (para. 105)
  - Limitation of benefits provisions and principles were not argued or considered (para. 106)
- CRA did not appeal the TCC decision.

TD Securities—Discussion Points

- Consistent with *Crown Forest,* TCC gave relevant treaty provisions a "liberal interpretation with a view to implementing the true intentions of the parties"
- Purposive and common sense approach reflected in conclusion that US LLC "liable to tax" in US even though income taxed at shareholder/member level

TD Securities—Discussion Points

- TCC considered extensive extrinsic aids relevant to treaty interpretation
- For post-treaty OECD Commentary, TCC applied FCA reasoning in *Prevost*—such commentary relevant provided doesn't conflict with contemporaneous commentary and no reservation by treaty partner
- Note that TCC limited decision to circumstances where all shareholders/members of US LLC are US residents

TD Securities—Discussion Points

- TCC rejected CRA position that US LLC not entitled to treaty benefits because not US resident for treaty purposes
- Article IV(6) of treaty added by Fifth Protocol intended to provide treaty relief for, *inter alia,* shareholders/members of US LLC
- TCC decision only dealt with years before February 1, 2009 effective date of Article IV(6)

TD Securities—Discussion Points

- Unfortunately, Article IV(6) has engendered difficult interpretive issues
- First, as noted in TCC decision, in case of US LLC by its language Article IV(6) extends treaty benefits to shareholders/members
- Problem is US LLC only “visible” taxpayer from Canadian tax perspective

TD Securities—Discussion Points

- To address language gap, CRA has taken common-sense view and treats US LLC as Canadian tax filer, but one entitled to claim treaty benefits of its shareholders/members resident in US
- TCC decision notes CRA position is sensible approach that achieves result consistent with purpose of Article IV(6)
- Resolution of second interpretive issue respecting Article IV(6) may prove more elusive

TD Securities—Discussion Points

- TCC decision may have important impact on ultimate resolution of second issue
- Article IV(6) provides treaty relief where US tax treatment of an income item derived by US resident shareholder/member through US LLC is same as if income item had been derived directly

TD Securities—Discussion Points

- Current CRA position is that Article IV(6) provides no treaty relief for amount derived by a shareholder of US LLC that is "disregarded" for US tax purposes (CRA Doc. No. 2009-0339191E5 and No. 2009-0345351C6)
- CRA concern that "disregarded" amount has no US tax treatment, thus, key condition for application of Article IV(6) not met

TD Securities—Discussion Points

- Impact of case on proper interpretation of Article IV(6) (including recent CRA position) unclear
- On one hand, TCC made it clear its decision did not mean US LLC or partnership that is fiscally transparent has option to rely on decision or Article IV(6)

TD Securities—Discussion Points

- TCC noted that language and context of the relevant treaty provisions, including Articles IV(6) and (7), would govern the proper interpretation of the revised treaty in application to US LLC or partnership in future
- Given Article IV(6) and other specific amendments, TCC suggested not reasonable to expect revised treaty would be applied in same manner
- In some respects, specific language of Article IV(6) difficult to overcome in case of "disregarded income"

TD Securities—Discussion Points

- On other hand, for same reasons endorsed by TCC—i.e., language overridden by context and purpose to produce common sense result that ensures consistent treatment of partnerships and US LLCs—good argument that treaty relief should be available for shareholders/members of US LLCs
- As well, not clear why Article IV(6) should not apply to partnerships and US LLCs on same basis—CRA may have different view

Trust Residence

Trust Residence – Background

- Judicially-established test for trust residence (*Thibodeau*, 1978 FCTD)
  - Trust resident where majority of trustees are resident, provided that matters are decided by a majority of trustees
  - Judicial formula for corporate residence cannot apply because trustees cannot delegate authority or adopt a “policy of masterly inactivity”
- Became the well-accepted test (despite expressly limited scope of *Thibodeau* decision)

Trust Residence – *Garron* (2009 TCC)

- PMPL held two operating companies
  - Manufactured products for auto industry
- Owned by Garron family and Dunin, a key employee
- Following a freeze transaction, nominal value common shares issued to holding companies held by two trusts

Trust Residence – *Garron*

- April 1998 freeze transaction valued PMPL at $50 million
- August 2000: PMPL sold for approx. $500 million
- As part of the sale, Trusts sold the shares in holdcos holding PMPL common shares, realized total capital gains of approx. $450 million

Trust Residence – *Garron*

- Claimed benefit of Canada-Barbados Treaty on grounds that Trusts resident in Barbados
- Standard treaty "resident" definition
  - Liable to tax in a state by reason of domicile, residence, place of management or any other criterion of a similar nature
  - No special rule for trusts; tie broken by Competent Authority

Trust Residence – *Garron*

- The Trusts:
  - Settled by a friend of Garron's living in St. Vincent
  - Beneficiaries: Garron/Dunin and families
  - Trustee: St. Michael Trust Corp., at the relevant time wholly-owned by PwC Barbados

Trust Residence – *Garron*

- Protector: another friend of Garron in St. Vincent
  - Has ability to remove and replace trustee at any time
  - Majority of beneficiaries over a certain age my replace protector
- Trustee's memorandum of intention for each Trust

Trust Residence – *Garron*

- Test for trust residence
  - *Thibodeau* does not establish a test based solely on residence of trustee applicable in all circumstances
    - Based on unreasonable assumption that trustees always comply with their fiduciary obligations
  - Central management and control is the appropriate test

Trust Residence – *Garron*

- "CMC" in the trust context
  - No definitive statement of principle
  - Cites *Wood v. Holden*
    - Mere shareholder influence not sufficient to find that board does not exercise CMC
    - Board must make decisions and must not be "dictated" to

Trust Residence – *Garron*

- Trustee provided administrative services only, no decision making
  - Role understood, enforceable through protector mechanism
  - "Substantive" decisions made by Garron and Dunin
  - Case of "dictation" as opposed to influence
    - Absence of persuasive evidence as to any meaningful role of the trustee

Trust Residence – *Garron*

- Taxpayers' case hindered by absence of persuasive evidence.
- Status of trustee relevant
  - Not a well recognized trust company
  - Liability limited in trust indenture
  - No presumption that fiduciary duty fulfilled
- Trusts resident in Canada and not in Barbados
- Appeal to FCA pending

Trust Residence – *Garron*

- *Obiter* comment on section 94 deemed residence
  - Deemed resident trust not a treaty resident of Canada
- 2010 Budget NRT proposals
  - ITCIA to be amended to provide that trust deemed resident of Canada under NRT rules is a treaty resident of Canada

Trust Residence – Discussion Points

History of the Residence of Trusts

- Generally, after Thibodeau (1978), it was thought that a trust was resident where the trustee was resident
- Garron suggests that there is no reason why the test for residency of trusts should not be the same as the test for residency of corporations under common law

Trust Residence – Discussion Points

The Garron Decision

- Decision does not necessarily mean that a trust is not resident where the trustee is resident; however, the trustee must exercise central management and control
- The lack of evidence about what the trustee actually did was critical to the holding at the Tax Court
- Taxpayers will want to ensure that trustees have central management and control and that evidence of their activities is available

Trust Residence – Discussion Points

- The decision aligns (arguably) with IT-447, “Residence of a Trust or Estate”, which says that a trust resides where the trustee who manages the trust or controls the trust assets resides.
- The decision reduces somewhat the ability to elect the location of trust residence

Trust Residence – Discussion Points

- The decision is relevant not only for determinations of residence where a trust has trustees outside of Canada – it is also relevant for inter-provincial trust planning

Trust Residence – Discussion Points

Design of Trust Arrangements

- Useful to ensure the following take place in the jurisdiction intended for residence:
  - Residence of majority of trustees
  - Meetings of trustees
  - Investment decisions
  - Banking, bookkeeping etc.
  - Management of business or property owned by the trust
  - Control over the assets of the trust
- Document transactions/activities

Trust Residence – Discussion Points

CRA response

- The CRA is undertaking an audit of trusts across Canada to determine residence and validity
- Questions posed by the CRA audit questionnaire include:
  - How were you appointed as the trustee? Who appointed you? When were you appointed? Why were you appointed? What is your relationship to the trust?
  - What is your qualification, expertise and experience?
  - Provide a list of your duties and responsibilities as the trustee

Trust Residence – Discussion Points

- Questions from the CRA audit continued:
  - Are you responsible for the management of any business or property owned by the trust? How is this done?
  - Are you responsible for banking and financing arrangements for the trust? How is this done?
  - How are decisions in relations to the trust property made? Where are the decisions made? Who makes these decisions? ....

Trust Residence – Discussion Points

Points on Appeal

- Control test does not apply to trusts
  - Does not line up with the statutory scheme
  - Corporations and trusts have significant differences
  - If the control test does apply, control was exercised in Barbados