THE USE OF OEEC-OECD HISTORICAL DOCUMENTS IN INTERPRETING TAX TREATIES

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Availability of Historical Documents

On the website, www.taxtreatieshistory.org, the French and English versions of documents prepared between November 12, 1954 and November 19, 1963 relating to the 1963 OECD Draft *Double Taxation Convention on Income and Capital* (the "1963 Draft") are now available.[1] The website also includes copies of the comments by interested parties on the 1963 Draft and other documents of interest through to September 3, 1964. In total, the website includes internal documentation relating to the 1963 Draft covering a period of approximately 10 years. It is hoped that this very useful material (a total of 747 documents in all) will constitute only the first release by the OECD of this kind of documentation which may prove helpful to scholars, tax practitioners and courts in better understanding what meanings the drafters intended for the OECD Model and Commentaries in their various versions, both as originally formulated and as later frequently changed and updated.

Use of These Materials under International Law

As has now been widely accepted by scholars, practitioners and courts, tax treaties, like other treaties, are to be interpreted by the application of the principles of interpretation recognized in international law as codified (in part) by Articles 31 to 33 of the Vienna Convention on the Law of Treaties (the "VCLT"). Scholars, practitioners and courts have long had difficulty in fitting the OECD Commentaries into the all too brief and seemingly rather rigid rules set down in Articles 31 and 32 of the VCLT and one expects they will have further debates and probably difficulties fitting the preparatory work of the 1963 Draft into these rules as the documents, compared with the Commentaries, are a further step removed from the final version of the 1963

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[1] The website acknowledges the assistance of the Institute for Austrian and International Tax Law (WU), IBFD, Universita Cattolica del Sacro Cuore, International Fiscal Association Canadian Branch and the Canadian Tax Foundation as the sponsors of the site.

Draft and, therefore, further away from being compatible with the provisions of Articles 31 and 32 of the VCLT than the Commentaries themselves.

A Commentary on the penultimate draft Articles 31 and 32 of the VCLT prepared by the International Law Commission may, however, be of assistance in opening the way to admit a broader basis for the use of techniques and materials for the interpretation of treaties than may seem to be permitted by the VCLT, as that Commentary points out that:

> "[S]tatements can be found in the decisions of international tribunals to support the use of almost every principle or maxim of which use is made in national systems of law in the interpretation of statutes and contracts…
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> Thus it would be possible to find sufficient evidence of recourse to principles and maxims in international practice to justify their inclusion in a codification of the law of treaties, if the question was simply one of the relevance on the international plane. But the question raised by jurists is rather as to the non-obligatory character of many of these principles and maxims. They are for the most part, principles of logic and good sense valuable only as guides to assist in appreciating the meaning which the parties may have intended to attach to the expressions that they employed in a document."[2]

It probably should be understood that academics and scholars are frequently involved in issues of the proper interpretation of the various versions of the OECD Model whereas practitioners and courts are one step further away from that as their work involves the interpretation of actual tax treaties made between Contracting States which may follow more or less closely, as the case may be, the provisions of a version of the OECD Model or of other models such as the UN Model or the model tax treaty of one or both of a particular Contracting State. The rules codified in the VCLT should, however, not exclude references to any relevant materials. As Sir Ian Sinclair wrote:

> "[I]t is clear that no would-be interpreter of a treaty, whatever his doctrinal point of departure, will deliberately ignore any material

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[2] Paragraphs 3 and 4 of the Commentary on draft Articles 27 and 28 of the VCLT. For further discussion, see David A. Ward, *et al*., *The Interpretation of Income Tax Treaties With Particular Reference to the Commentaries on the OECD Model* (IFA Canadian Branch and IBFD, 2005) at p. 27 *et seq.* and the Commentaries on the Draft VCLT at p. 177 *et seq.*

> which can usefully serve as a guide towards establishing the meaning of the text with which he is confronted." [3]

The Value of These Historical Materials, a Canadian Case Study

The purpose of this brief article is to illustrate, by reference to the well-known decision of the Supreme Court of Canada in *The Queen* v. *Crown Forest Industries Limited,*[4] how a reference to these early materials might shed light on the intentions of the drafters of the OECD Model and of a tax treaty derived from that Model, concentrating solely on Article 4(1) of the 1963 Draft and the Commentary on that provision of the Draft. The issue in *Crown Forest* was the proper interpretation of Article IV(1) of the Canada-United States Income Tax Convention (the "1980 Convention"), which was signed after the publication of the 1977 OECD Model and before the 1992 update which led the Supreme Court to conclude that the 1980 Convention was drafted on the basis of the 1977 version of the OECD Model. The relevant provision of the 1980 Convention reads as follows:

Article IV

> "1. For the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature, but in the case of an estate or trust, only to the extent that income derived by such estate or trust, is liable to tax in that State, either in its hands or in the hands of its beneficiaries."[5]

The issue in the *Crown Forest* case was whether the Canadian resident corporation, Crown Forest, in paying rental payments to the non-resident, Norsk Pacific Steamship Company, was obligated to deduct withholding tax at the Canadian statutory rate of 25% or only to withhold tax

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3 *The Vienna Convention on the Law of Treaties*, (2nd ed. Manchester University Press, 1984) at p. 116.

4 95 DTC 5389. John Avery Jones and other members of the International Tax Group have written an article on this case, this author acting as an emanuensis for the group, David A. Ward, *et al.*, "A Resident of a Contracting State for Tax Treaty Purposes: A Case Comment on Crown Forest Industries", 1996 Canadian Tax Journal, p. 408 (herein the "1996 article").

5 The second sentence in Art 4(1) of the 1977 OECD Model (added in 1977) was not included in the 1980 Convention as it was thought to be irrelevant to Canada, a country that taxes its residents on a worldwide basis and inappropriate to countries that tax on a territorial basis: Brian Ernewein's answer quoted in R. Couzin and S. Ruby, "The Impact of Recent Cases", 1998 Canadian Tax Foundation Conference Report, p. 52:1 at p. 52:29. Its absence was the cause of much discussion by the Court, which is not dealt with here.

at the treaty rate of 10%. This turned on the issue of whether Norsk was resident in the United States under Article IV(1) of the 1980 Convention.

Norsk, a corporation incorporated in Bermuda, had a place of management in the United States, it carried on trade or business in the United States and was taxable there on income effectively connected with that trade or business.[6]

The majority of the panel of judges in the Federal Court of Appeal in *Crown Forest* had found that the treaty rate was applicable because Norsk was a treaty resident of the United States as it had a place of management in the United States and its place of management was a prime factor in its liability to tax in the United States. This was reversed in the Supreme Court by the unanimous decision of a panel of seven of the judges, Iacobucci J. providing the reasons for judgment of the panel. In the course of the reasons for judgment, Iacobucci J. noted correctly that if Norsk's liability arose from the fact that "it is engaged in a trade or business effectively connected with the US", it would not be a resident of the United States under Article IV since being "engaged in a trade or business is not listed as a factor to trigger residency under that Article". He noted there is an important *caveat* under Article IV as it must be shown that the liability to taxation operates *by reason of* one of the listed grounds indicating the existence of some sort of causal connection. The Court found that Norsk's place of management in the US was not causally or even proximately connected with the basis for its tax liability in the US. To the contrary, the Court found that the reason why Norsk was liable to taxation in the US was because of the income flowing from its trade or business that was conducted in the United States. Put shortly, the Court held that "the veritable lynch pin of Norsk's US tax liability is the 'engaged in a trade or business' criterion not in the place of management". Therefore, the Court below had erred in interpreting the expression "by reason of" in Article IV(1) of the Convention. Unfortunately, however, Iacobucci J. added in *obiter*:

> "In this respect, the criteria for determining residence under Art. IV.1 involve more than simply being liable to taxation on some portion of income (source liability); they entail *being subject*

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[6] Under section 883 of the Internal Revenue Code of 1986 and a treaty between the United States and Bermuda, Norsk as an "international shipping company" may not, in fact, have been taxable in the United States on these rents: Gordon Williamson, "New Developments Affecting International Corporate Finance", 1997 Corporate Management Tax Conference (Can. Tax Foundation), p. 15:1 at p. 15:5.

> *to as comprehensive a tax liability as is imposed by a state*. In the United States and Canada, such comprehensive taxation is taxation on world-wide income."[7]

In the course of the reasons for judgment, Iacobucci J. also said:

> "… I find persuasive the submissions that only those corporations that are *liable to taxation for the full amount of their world-wide income* meet the definition of 'resident' in [the 1980 Convention]."[8]

These controversial *obiter* statements were obviously influenced by the following paragraphs of the 1977 Commentary on Article 4:

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[7] Page 5395, emphasis added. As is discussed below, correctness of these two sentences, particularly the emphasized words, may be questioned based on the historical documents and was, in fact, criticized by the International Tax Group in the 1996 article, Note 4. These words have also led to a widespread debate among Canadian commentators and apparent confusion in the Canada Revenue Agency and amongst practitioners as to the interpretation of the residence article in Canada's tax treaties. See, for example, Paul Hickey, "Tax Treaty Residence" (2007) vol. 15, no. 4 Canadian Tax Highlights p. 2; S. Jack, T. Murphy, M. Robinson, M. Vanasse and A. White, "Canada Revenue Agency Round Table", 2005 Conference Report (Canadian Tax Foundation) (herein "Conference Report"), p. 6A:1 at p. 6A:38 *et seq*.; Brian Arnold, "Unlinking Tax Treaties and Foreign Affiliate Rules: A Modest Proposal", 2002 Canadian Tax Journal, p. 607 at p. 614 *et seq*.; Doug Connell and Sandra Goldberg, "Barbados as a Base for Off-Shore Activities", 2002 Conference Report, p. 19:1 at pp. 19:4-5 and p. 19:10; Marc Darmo and Steve Dunk, "Rethinking the Canadian Inbound Business Model", 2001 Canadian Tax Journal, p. 148 at p. 153; Robert Couzin and Stephen Ruby, "The Impact of Recent Cases", 1998 Conference Report, p. 52:1 at pp. 52:25 *et seq*. and p. 52:29; Eric Lockwood and Michael Maikawa, "Foreign Affiliate and FAPI: Problems and Tax Planning Opportunities Resulting From the 1995 Changes", 1998 Canadian Tax Journal, p. 377 at p. 382 *et seq*.; Allan Lanthier and John Meek, "Canadian Foreign Affiliate Rules", 1997 Conference Report, p. 31:1 at p. 31:11, where they say, "The Supreme Court decision in *Crown Forest* has started us down what may prove to be a long and somewhat treacherous road and one where the ultimate destination will not always be certain."; Allan Lanthier and James Tobin, 1996 Conference Report, p. 36:1 at p. 36:23 where they say, "In the authors' view, however, Revenue Canada has misinterpreted *Crown Forest*, which on a proper analysis, requires not that a taxpayer be subject to worldwide taxation to qualify as a treaty resident, but rather that it be subject to the comprehensive tax laws of a particular country."; Larry Chapman, "Emerging Tax Issues: Treaty Interpretation and Crown Forest Industries Ltd., Income of Financing Affiliates and the New FAPI Rules, Formation of Financing Affiliates by Non-Resident-Owned Canadian Companies", 1995 Conference Report, p. 6:1 at p. 6:3 where he says, "This would be in accordance with the commonly held view in the literature that residency is not conditional on actual taxation, only on the taxpayers meeting one of the criteria which under the domestic law of that state attract taxation as a resident."; Peter MacDonald, "The Test of Residency: 'Liable to Tax' or Something More?", 2007 International Tax Planning, p. 970; Drew Morier, "Treaty Residence of French Partnerships Subject to Corporate Tax", 2002 International Tax Planning, p. 745; Joel Nitikman, "Do the New Non-Resident Trust Rules Override Crown Forest?", 2000 International Tax Planning, p. 677; Eric Lockwood, "Malaysia: Offshore Tax Planning Without Labuan?", 1999 International Tax Planning, p. 552 where he says in footnote 4, "How the phrase 'As comprehensive a basis of taxation as is imposed by the state' will be interpreted in particular situations, and what bearing might reducing tax incentives or exemptions have, is not entirely clear."; Scott Scheuermann and Richard Tremblay, "The Exempt Insurance Act of Barbados Under Attack", 1996 International Tax Planning, p. 340; and Canada Revenue Agency's *Technical News* No. 35 of February 26, 2007.

[8] Page 5399, emphasis added. It may be that Justice Iacobucci was using the words "liable to" and "subject to" interchangeably. See the comment below on the meaning of "liable".

> "3. Generally, the domestic laws of the various States impose a comprehensive liability to tax – 'full tax liability' – based on the taxpayers' [sic] personal attachment to the State concerned (the 'State of residence')."
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> "8. As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax)."

In both of these paragraphs, the concepts of "full tax liability" or "full liability to tax" falling within quotation marks or parentheses seem to be concepts defined by the words preceding, namely, "a comprehensive liability to tax" or "a comprehensive taxation". The judgment in the Supreme Court appears to have reversed this and coloured the words "a comprehensive liability to tax" or "a comprehensive taxation" in each case to mean a full tax liability and by stating further that full tax liability is not satisfied in a case where an entity is liable to tax in a jurisdiction only on a part of its income. This interpretation was supported by the Court with the following reference to *American Law Institute, Federal Income Tax Report – International Taxation Aspects to the United States Income Taxation II – Proposals on United States Tax Income Tax Treaties*:[9]

> "A person or entity is considered resident in a country if that country asserts an unlimited right to tax his or its income – that is a right based upon the taxpayer's personal connection with the country (as opposed to the source of the income or other income or assets-related factors). The test of residence requires that the person or entity claiming treaty benefits be 'fully taxable' in the residence country in the sense of being fully subject to its *plenary taxing jurisdiction*." [10] [Emphasis added.]

Missing from this quoted text is the next sentence:

> "It does not, however, require that a tax actually be paid to the residence country with respect to any particular item of income."

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9 The American Law Institute, Philadelphia, PA, 1992.

10 Page 128. Being "fully subject to a country's plenary taxing jurisdiction" is the same or virtually the same test as being "subject to the tax laws" of the country, the interpretation suggested in paragraph 8.5 of the OECD Commentary added in the 2000 update as paragraph 8.2. It does not suggest that the test is that the taxpayer is "subject" to tax on all his income in the sense that such tax is actually payable.

Perhaps, more interesting, is what one finds in the historical OEEC-OECD documentation. This shows that the delegates to the Fiscal Committee of the OEEC assigned the responsibility of dealing with the definition of "fiscal domicile" in what became the 1963 Draft were those from Denmark and Luxembourg who formed Working Party 2 ("WP2"). See FC/M(56)1. WP2 drafted various definitions of fiscal domicile, the first on October 2, 1956 (FC/WP2(56)1) which focused on two cases of double taxation, the first where two states impose "full liability" on a taxpayer on account of the taxpayer's personal attachment to the two states, and in the second where one state taxes on a source basis and in the other state the taxpayer is burdened with full tax liability based on personal attachment. At page 3 of this report, WP2 further qualified "full tax liability" by using the phrase, "the full right to tax". At page, 5, the report refers to the "right to tax" (except on a source basis) being reserved in exiting treaties as belonging to the state in which the taxpayer is domiciled. At page 6, the report again refers to a "right to tax" in respect of the residence of a taxpayer and this is then expressed as "full tax liability" at page 7 and "unlimited tax liability" which was contrasted with "tax at source" on page 8. This first draft discussed the basis on which of the taxpayer's personal attachments WP2 thought residence should be determined.[11] This draft was rejected by the Fiscal Committee at a meeting in October 1956 (FC/M(56)2) which indicated a preference to developing a definition that could be accepted by all member countries of the OEEC, without them changing their internal laws. Also, dealing with double taxation of a taxpayer in his residence state and in the state of source was not appropriate in an article intended to define the term "fiscal domicile" or "resident".

FC/WP2(57)1 of May 27, 1957, provided a second draft treaty article which used the concept of being "fully liable to taxation" in a member country as the test of fiscal domicile (which is a parallel concept to the relevant part of the *American Law Institute Federal Income Tax Report*[12] of being "subject to the plenary taxing jurisdiction of a state") and "limited liability to taxation" to refer to source taxation. In the Comments on the draft article, the term "fully liable to tax" was used to explain the meaning of "fully liable to taxation". The Comments also used the term "limited liability to tax" in place of "limited liability to taxation" which appeared in the draft article. Interestingly, on page 9 of the Comments on the draft articles, the terms "limited liability

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11 Clearly, in this draft the expression "full tax liability" was used to distinguish residence-based taxation from source-based taxation.

12 Note 9.

to taxation" and "limited liability to tax" and "fully liable to taxation" and "fully liable to tax" are used interchangeably indicating they mean the same thing and are used only to distinguish between taxpayers who are resident in a Member country and taxable there because of their resident status from taxpayers who are taxed by a Member country only on income sourced there because they are not resident there. This draft then dealt with a tie-breaker rule to apply in the case a person was fully liable to taxation in more than one member country. It also went much further and gave a country where the person was fully liable "the right to tax all income other than that specifically liable to taxation in another country under the treaty". This draft was found unsatisfactory at a meeting in June 1957 (see FC/M(57)2) where the Fiscal Committee found the draft gave no definition of "fiscal domicile" but rather it directly proposed rules being based on the concept of the taxpayer's "full liability" to tax. The Fiscal Committee concluded that the definition should not rely on "full liability" to tax but should rely on national concepts to define "fiscal domicile".

The third draft of WP2 was in their report dated September 19, 1957 (FC/WP2(57)2). The report also included a draft article proposed by the Swiss delegation, that stated an individual or a legal person shall be deemed to be domiciled where he or it is "fully liable to taxation", and that liability had to be by virtue of domicile, residence, headquarters, nationality or some similar criterion in internal fiscal law. The draft prepared by WP2 used the same phrase and also dealt with a person who "has a limited liability to taxation in a member country in respect of income originating in that country" and purported to give the right to tax to the country in which the person is fully liable to taxation unless it is otherwise provided in the following articles of the tax treaty. These drafts were considered by the Fiscal Committee at its meeting in October 1957 (FC/M(57)3) and were also rejected by the Committee which concluded that the question whether the right to tax should be conferred on the country of source or the country of domicile, residence, head office or nationality was not a matter to be determined by the Article on the definition of "fiscal domicile". The minutes state, "It was agreed not to use the expression 'fully liable to taxation' which introduced a new concept into the question of liability to tax". The Fiscal Committee then asked WP2 to present two alternative drafts for their next session.

WP2's fourth effort is found in document FC/WP2(57)3, dated November 5, 1957. In this draft, in the definition of a resident, WP2 suggested the following: "The term 'resident' of the state

means any person who under the national laws of that state, is subject to tax in that state as a resident." This document also presented various arguments supporting some of the previously rejected drafts that had used the contrasting expressions, "full liability to taxation" and "limited liability to taxation" to distinguish between liability based on fiscal domicile from liability based on source. As to the word "full", to which the Fiscal Committee had objected in FC/M(57)2 and FC/M(57)3, at page 5, the document states:

> "At any rate, the word 'full' would presumably have to be dropped. This would mean that in the subsequent articles of the Convention the brief expression 'the State in which he is fully liable to taxation' could not be used, but it would be necessary to say 'the State in which he is liable to taxation by reason of domicile, residence, etc.' For terminological reasons it would be desirable if 'a shorthand expression' could be used in all cases where the State of 'domicile' is mentioned… [The Working Party] has fixed on the term 'resident'… ."

The next relevant document, TFD/FC/27 dated November 26, 1957, is a document prepared by the Trade and Financial Directorate of the OEEC, from which a functionary (the "Secretariat") had been seconded to assist the Fiscal Committee. The proposed definition in this document comes closer to the final definition of a resident stating:

> "For the purposes of this Convention, the expression 'resident' of a State means any person who, under the national law of that State, is *liable to taxation* therein by reason of his domicile, residence, head office, nationality or some other similar personal criterion." [Emphasis added.]

The document also deals with tie-breaker rules to apply to dual resident taxpayers. It was prepared during a meeting of the Fiscal Committee held in November 1957 (FC/M(58)1) at which the new draft article in WP2's third report was examined. The Fiscal Committee in its minutes stated that it decided to use the term "resident" in the French text as well as the English text and decided that the draft article should commence with the following definition: "For the purposes of this Convention, the expression 'resident' of a state means any person who, under the national law of that state, is liable to taxation therein by reason of this domicile, residence, place of management or any other similar criterion." This, of course, is similar to the definition prepared by the Secretariat. It is relevant to note that this formulation uses the expression "liable

to taxation" as did the Secretariat, unlike WP2, which used the expression "subject to tax". However, the Fiscal Committee's draft departed somewhat from the Secretariat's version in the listed criteria and dropped the qualifier "personal" in reference to "similar criterion".

The final report of WP2 on this subject is dated January 10, 1958, (FC/WP2(58)1). The Report (page 2) sets out the draft Article, paragraph I of which reads:

> "For the purposes of this Convention, the expression 'resident of a State' means any person who, under the national law of that State, is *liable to taxation* therein by reason of his domicile, residence, place of management or any other similar criterion." [Emphasis added.]

This definition of a resident is accompanied by a Commentary, the interesting part of which is the fifth paragraph on page 3 which uses the previously questioned word "full", but in a different context and states:

> "Generally the national legislations of the various States impose *a more comprehensive liability* to tax – 'full tax liability' – on account of the taxpayer's personal attachment to the State concerned (the State of 'domicile')." [Emphasis added.][13]

The Commentary also explains, on page 5, the term resident as follows:

> "As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the national fiscal legislations, form the basis of *a more comprehensive taxation* (full liability to tax)." [Emphasis added.][14]

Because of the position of the Fiscal Committee in FC/M(57)2 and FC/M(57)3 that the expression "fully liable to taxation" should not be used in defining a resident of a state because it introduced a new concept into the question of liability to tax, it is suggested that the use of the expression "full tax liability" in the Commentary was not meant to explain what was "a more

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13 As the earlier attempts at defining a resident had dealt with residence-based and source-based taxation on a comparative basis, obviously the word "more" was intended to distinguish the residence-based taxation from source-based taxation, in the sense that the former is "a more comprehensive" basis of taxation than the latter.

14 Again, the phrase "a more comprehensive taxation" should also be understood in the context of the various previous draft definitions to have been intended to mean: a more comprehensive liability to taxation than the liability to taxation of a non-resident who is liable to taxation only on a source basis.

comprehensive liability to tax" nor play any part in the definition of a resident, rather it seems to have been used in a way that takes its meaning form the expression, "a more comprehensive liability to tax" or "a more comprehensive taxation". If it is to be understood that way as a term taking its meaning from the expression, "a more comprehensive liability to tax", then the concept of "full liability to tax" is a defined term.

In Annex III of the Fiscal Committee's draft Report to Council (FC (58)2) of February 13, 1958, the definition again reads:

> "For the purposes of this Convention, the expression 'resident' of a State means any person who, under the national law of that State, is *liable to taxation* therein by reason of his domicile, residence, place of management or any other similar criterion."[15] [Emphasis added.]

There was no Commentary attached. This Report, however, in its draft form was considered by the Fiscal Committee at its meeting in February 1958 (FC/M/(58)2), where it was agreed to add the word "Contracting" before "State" and the Commentary was sent to the Secretariat to revise. This was done in the draft Report of the Fiscal Committee to the Council dated April 19, 1958 (FC(58)2). In Annex II of that Report, the definition had been slightly changed to change the reference to national law to a reference to "the law of that State". The Commentary is found at FC(58)2 (First Revision) Part II, page 16 *et seq*. Paragraph 3 states:

> "Generally the national legislations of the various States impose *a more comprehensive liability to tax* – 'full tax liability' on account of the taxpayer's personal attachment to the State concerned (the State of 'domicile')." [Emphasis added.]

In paragraph 10 it is stated:

> "As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the national fiscal legislations, form the basis of *a more comprehensive taxation* (full liability to tax)." [Emphasis added.]

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[15] The only difference between the definition on the previous definition in FC/WP2(58)1 is that the defined term became "resident" instead of "resident of a State".

The last available Report of the Fiscal Committee to Council dealing with this subject is found at C(58)118 Part I dated May 28, 1958 and Part II dated May 22, 1958 in which there are no material changes. In the published Report of the Fiscal Committee of the OEEC dated September 1958, also found in Volume 4 *Legislative History of U.S. Tax Conventions,*[16] the same definitions of "resident of a Contracting State" and Commentary are found as were used in defining a resident of a Contracting State in terms of "liability to taxation" and in explaining in paragraphs 3 and 10 of the Commentary that "full tax liability" means *a more* comprehensive liability to tax.

The interesting thing is that when the 1963 Draft was published by the OECD, the word "more" had been dropped from the phrase "a more comprehensive liability to tax" in paragraph 3 of the Commentary but still continued in paragraph 10.[17] When the 1977 Model was published, the phrase "liability to taxation" in Article 4(1) became "liability to tax" and the word "more" in paragraph 10 was also dropped from what became paragraph 8 of the Commentary on Article 4 of that Model. There is no document available which discusses these changes nor the reason for them.

The changes to the 1963 Draft were not referred to by the Supreme Court in *Crown Forest*. The 1977 Model and Commentary were the only versions referred to and seemed to have influenced the Supreme Court to conclude that the phrase "liable to tax" in the 1977 Model and the preceding words in the Commentary of "a comprehensive liability to tax" followed by the words "full tax liability" were to be interpreted on the basis that the expression "a comprehensive liability to tax" took its meaning from the expression "full tax liability" rather than the other way around which apparently was what was originally intended.

This leaves a number of issues open, particularly for Canadian taxpayers, as to whether taxpayers in Canada who are residents of Canada under the *Income Tax Act* but enjoy exemptions from tax or exclusions from taxable income in respect of parts or all of their income come within the

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16 U.S. Government printing office, Washington, 1962, 4445 at p. 4479 and p. 4499 *et seq*.

17 See also the Fiscal Committee's Report to the Council, C(63)87 Part 2 of July 6, 1963 where this change also appears. It is likely that this change was made by the Secretariat and was not noticed by the Fiscal Committee. See the Secretariat's Draft: FC(63)4 Part II dated May 3, 1963 which was considered by the Fiscal Committee in May and June 1963, FC/M(63)4 and FC/M(63)5 Part I.

definition of a resident of Canada in its tax treaties that are based on the OECD Model. Of course, the Supreme Court decision is not legally binding on Canada's tax treaty partners who may, and in fact often do, extend tax treaty benefits to Canadian resident taxpayers who are exempt from Canadian income tax on all or certain parts of income that they earn. These Canadian resident taxpayers include, for example, resident life insurance companies which are not taxed on non-Canadian life insurance business profits, status Indians resident in Canada who are not taxed on income earned on a reserve, and tax-exempt resident charities, pension and retirement arrangements, not-for-profit entities and governments themselves.[18]

Paragraph 8.5 of the OECD Commentary on Article 4 (which was added in 2000 after *Crown Forest* was decided then numbered paragraph 8.2) points out that, in many States, persons are considered to be "liable to comprehensive taxation" even if the Contracting State does not in fact impose tax. The Commentary mentions as examples, pension funds, charities and other organizations exempted from tax in the tax laws only if they meet all other requirements for exemptions specified in the tax laws. The Commentary states these entities are "subject to the tax laws"[19] and, if they do not meet the standard specified, they are also required to pay tax. The Commentary states that most States would view these entities as residents for the purposes of the Convention.

Paragraph 8.6 (also added in the year 2000 and then numbered paragraph 8.3) notes that some states do not consider the entities referred to in paragraph 8.5 as liable to tax if they are exempt under domestic laws and therefore they may not treat the entities as residents for the purposes of a Convention unless the entities are expressly covered by the Convention.[20]

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[18] As to governments, see the amendment to Article 4(1) of the OECD Model in the 1995 update to the Model and paragraph 8.1 of the Commentary on Article 4 added in 1992.

[19] This is effectively the same interpretation of Article 4(1) as that of the American Law Institute, Note 9 which is "being fully subject to [the country's] plenary taxing jurisdiction."

[20] This dissenting Commentary does not mention entities that are liable to taxation as residents, but are exempted from tax on certain items of income that are subjected to taxation in the hands of other resident taxpayers. The issue of the meaning of "liable to tax" is discussed extensively in *Residence of Companies under Tax Treaties and EC Law*, G. Maisto, ed. (IBFD, 2009) by R. Vann, Chap. 7 at pp. 231-2, fn 45, 246-8, 255-261; and in respect of interpretation of treaties in Austria, Belgium, Canada, France, Germany, Italy, Netherlands, South Africa, Spain, Switzerland and United States, respectively by Simader, Chap. 12 at pp. 359-61; by Bammens, Chap. 13 at pp. 391-396; by Brooks, Chap. 14 at p. 425 *et seq.*; by de Boynes, Chap. 15 at p. 453 *et seq.;* by Englisch, Chap. 16 at p. 497; by Tenore, Chap. 17 at 546; by de Boer, Chap. 18 at pp. 583-9; by Hattingh, Chap. 19 at p. 715; by Martinez Giner, Chap. 20 at pp. 778-784; by Maraia, Chap.

In light of the foregoing analysis and discussion, it is suggested that the wording of Article 4(1) of the Model is consistent with the Commentary adopted by the Fiscal Committee in May 1958 (FC/M(58)2) (First Revision) Part II, *supra* that qualified "a comprehensive tax system" with the word "more". The term "liable to" could and should be interpreted on a basis consistent with the historical documents that show the intention in drafting Article 4(1) was to describe a taxpayer who is treated as a resident under the tax laws of a Contracting State to be determined on the basis of being liable to "a more comprehensive tax" or "taxation" (as the Commentary on the 1963 Draft said) imposed on residents in comparison with non-residents.[21]

There is another way to approach the meaning of Article 4(1) by carefully considering the terms used which, of course, does not use the expressions, "full tax liability" or "fully liable to tax", found in the Commentary. *A Dictionary of Modern English Usage*[22] (herein "Fowler") explains that the meaning of the word "liable" has consistently shifted, possibly because it is a more or less isolated word lacking connections to keep it steady. The dictionary refers the reader to the word "apt" for its proper use and discusses the proper use of the words "apt, liable, likely, prone and calculated"[23] stating that when "liable" is followed by "to" with the infinitive it may have a meaning in the sense of being exposed to a risk:

> "It may perhaps be laid down that *apt* is the right [word to be used] except when the infinitive expresses not merely an evil, but an evil that is one to the subject… and therefore *liable* is right, in: We are *[liable] to be overheard* (being overheard is an evil to us)."

Therefore, the expression in Article 4(1) of being "liable to tax" (which is a cryptic way of saying "liable to be taxed"), because tax is usually considered by taxpayers as an evil to them, properly understood in the English language means, applying Fowler's analysis, that person is at a risk of being taxed by reason of the criteria mentioned. It does not mean that the person is

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21 at p. 810 and by Brauner, Chap. 23 at pp. 876-7. Somewhat diverse views of the meaning of this term are expressed in these various chapters that are also reflected in paragraphs 8.5 and 8.6 of the OECD Commentary on Article 4 although the views also deal with entities that are taxable as residents but enjoy exemptions or exclusions on some parts of their incomes.

21 See also the discussion of the French language term, "*est assujettie à l'impôt"* and the term in other languages in the 1996 Article, Note 4.

22 By H.W. Fowler, 2nd edition revised by Sir Ernest Gowers (Oxford at Clarendon Press, 1968), at page 333.

23 *Ibid*. p. 33.

actually taxed. It is suggested that the term "liable to" was chosen carefully and should always be used in discussing the definition of a resident of a Contracting State in Article 4(1) and not the more ambiguous term "subject to" which can signify that the person is actually taxed but not merely at risk of being taxed. The meaning of Article 4(1) was even clearer and more grammatical when the word "taxation" was used in place of the word "tax" in Article 4(1) of the 1963 Draft. The term "subject to taxation", has a closer meaning to "liable to tax", if it is used in reference to the *taxation laws*, as in: "subject to the taxation laws by reason of domicile, residence, place of management or a similar criterion".[24] Unfortunately, the difference between the meanings of "liable to" and "subject to" was not apparent in the interchangeable use of the terms in the reasons for judgment in the *Crown Forest* case, where the wrong term was used in the controversial *obiter* statement, "… the criteria for determining residence under Art. IV.1 involve more than simply being liable to taxation on some portion of income (source liability); [which, so far seems clearly correct] they entail being subject to as comprehensive a tax liability as is imposed by a State" which is the part of the sentence that goes beyond the textual meaning of the treaty and the accepted interpretation of it by the treaty partner, in the United States as set out in the American Law Institute publication[25] and is inconsistent with the apparent intended meaning of "a comprehensive liability to tax" as shown by the historical documents.

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[24] In Fowler, the word "subject" is dealt with by saying it is synonymous with "theme": page 595. See also the definition of "subject" in the *Oxford Shorter English Dictionary* which discusses the word in terms of both a risk of and an occurrence of an actual event.

[25] Note 9.