Articles

FISCAL RESIDENCE OF CORPORATIONS IN CANADA

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Au sens de la *Loi de l'impôt sur le revenu* (canadienne), les mots "personne" et "contribuable" comprennent les corporations. Par conséquent, les corporations, tout comme les particuliers, ont intérêt à déterminer le lieu de leur résidence aux fins de l'assujettissement à l'impôt sur le revenu au Canada. La ligne de conduite suivie par les tribunaux a été d'assimiler, en autant que faire se peut, individus et corporations. Pour reprendre les termes employés par Lord Loreburn "une corporation ne peut ni boire, ni dormir,... elle peut cependant tenir maison et faire affaires" (traduction).

Un premier test, élaboré en 1906 par la House of Lords dans l'affaire *DeBeers Consolidated Mines Limited* v. *Howe*, fixait la résidence d'une corporation "là où elle fait réellement affaire... là où siège l'administration centrale" (traduction). Ce critère, bien que n'ayant jamais été écarté formellement, a souvent été nuancé pour solutionner des cas d'espèce dont nous ferons état dans cet article.

Pour certaines corporations, la question est tranchée de façon péremptoire par des présomptions énoncées dans le texte de la *Loi*. On doit également prendre en considération les traités internationaux lesquels revêtent une importance grandissante dans ce domaine.

En 1926, dans l'affaire *Reid* v. *C.I.R.*, Lord Clyde, éminent juge écossais, éprouvait de la difficulté à définir l'expression "résident ordinaire" un concept "tellement dilué... qu'il devient difficile d'invalider une décision rendue (par l'administration) sur la base d'une donnée de faits en particulier" (traduction). Ce constat demeure valable; même de nos jours, si les principes sont clairs, leur application souvent ne l'est pas.

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INTRODUCTION

> "Residence, when applied to individuals, does not necessarily mean the location of the permanent home, but is best defined as 'habitual physical presence' in a country. That is a concept readily applicable to natural persons, but one which raises difficulties, when applied to legal or artificial persons. A company's shareholders and its directors may be distributed throughout the world, and it may trade on an international scale. Thus, the identification of its 'physical presence' will depend upon the selection of certain characteristics as more relevant than others"[1].

The words "persons" and "taxpayers" as used in the *Income Tax Act*[2] include corporations (section 248(1)). As Hogg points out, "[i]t is therefore as necessary for a corporation as it is for an individual to determine the place of residence in order to decide whether it is liable to Canadian tax on its world income. In the absence of any exhaustive definition of residence in the Act, the courts have had to develop a test of residence for corporations just as they have for individuals"[3].

The principle adopted by the courts has been to assimilate, as much as possible, the corporation to the individual. As Lord Loreburn said in *DeBeers Consolidated Mines Limited* v. *Howe*[4], "[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". His Lordship's conclusion (based, in part, on what had been said by the Exchequer Division 30 years earlier)[5] was that "a company resides for purposes of income tax where its real business is carried on... and the real business is carried on where the central management and control actually abides"[6].

This rule, though never set aside, has often been distinguished. It is the evolution and application of this general principle regarding the

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1. *Simon's Taxes*, Vol. D, 3rd ed., 603 and ff., (looseleaf service), Butterworths, London.
2. R.S.C. 1952, c. 148, and amendments.
3. Peter W. HOGG, *Notes on Income Tax*, 2nd ed. (1979) chap. 8: 19, Osgoode Hall Law School, York University, Toronto.
4. [1906] AC 455, 458 (HL).
5. In *Calcutta Jute Mills Company Limited* v. *Nicholson*, (1876) 1 EX.D. 438 and *Cesena Sulphur Co.* v. *Nicholson*, (1876) 1 EX.D. 428.
6. [1906] AC 455, 458 (HL). It is to be noted, however, that residence is sometimes "deemed" under the *Income Tax Act* and, further, that the terms of the bilateral tax treaties into which Canada has entered take precedence over

residence of corporations which is discussed in this paper. To do so, one must, of course, first turn to the *Income Tax Act*, for although corporate residence is not, *per se*, defined in the Act, a company may be, in certain circumstances, *deemed* resident. For instance, under subsection 250(4), any company formed in Canada after April 26, 1965, is deemed to be resident in Canada.

Deeming provisions in the Act, however, like international tax treaties, evolved over the years to respond to lacunae in the common law which was, for many years, and still is today in many instances, the first test for determining corporate residence. In examining corporate residence, I therefore propose to follow the chronological evolution: first the common law tests and general principles of corporate residence, then the statutory tests and, lastly, Canada's international tax conventions.

I. SIGNIFICANCE OF RESIDENCE FOR THE CORPORATION

For the purpose of taxation, it may be either advantageous or disadvantageous for a company to be a Canadian resident. Although it is beyond the scope of this paper to examine corporate taxation in detail, it is worthy of note that a company may derive great benefit from Canadian residence.

One objective of the Canadian *Income Tax Act* is to promote increased investment in Canada; another goal is to encourage the development of small business. In the latter case, in order to qualify for the small business deduction, it is necessary that the company not be controlled by non-residents and that it be a Canadian corporation, as set out in paragraph 125(6)(a). O.A. Pyrcz pointed out the possible importance of Canadian corporate status:

> "The implications of Canadian corporation status are numerous. A corporation with such status may qualify as a 'taxable Canadian corporation' [section 89(1)(i)], to enable its dividends to be deducted in computing the taxable income of its corporate shareholders. Similarly, only dividends from taxable Canadian corporations qualify for the dividend tax credit in the hands of individual shareholders... Such status will also entitle a corporation to the benefit of the various capital gains rollover provisions in the new Act..."[7]

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any inconsistent provisions of the *Income Tax Act*. This is discussed fully at pp. 532 and ff., *infra*.

7. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 375.

On the other hand, a less desirable implication of "Canadian corporation" status, as defined in paragraph 89(1)(a) of the Act[8], may be taxation on the global income of the company when it does not intend to be resident in Canada at all. This was the case in *Dominion Bridge*[9], where the taxpayer's subsidiary, Span, had been incorporated in the Bahamas. Although Décary J. held that the purpose of the incorporation of Span was a sham — as, indeed, were its operations — the same holding might have been arrived at by using the *de facto* management and control test[10]. This method would allow Canada to tax foreign earnings of subsidiaries which are, in fact, puppets of the parent company. In *Dominion Bridge*, all of Span's activities were dominated by the parent, to the point where its business was, in reality, that of Dominion Bridge. The result was that the subsidiary had become the parent's agent. An incorporation of an off-shore company in a "tax haven" must, therefore, be genuine and not merely an attempt to escape the long reach of the Canadian tax collector.

As pointed out above, the Act makes no attempt to define the term "residence",

> "... and for the nearly one hundred years... the courts have been occupied in its determination... But in no case has there ever arisen such circumstances as to enable the judges to give a comprehensive and clear-cut decision"[11].

It would, undoubtedly, be simpler to have clear-cut rules and decisions to follow. However, enormous benefits — or burdens — may be bestowed on a company (and its shareholders) by reason of its residence. Courts, therefore, although guided by long-established common-law principles of residence, are prepared, if necessary, to "distinguish" them to arrive at equitable and just results.

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8. This paragraph provides as follows:

   89(1) In this subdivision,

   (a) "Canadian corporation" at any time means a corporation that was resident in Canada at that time and was

   (i) incorporated in Canada, or
   (ii) resident in Canada throughout the period commencing June 18, 1971 and ending at that time.

9. *Dominion Bridge Company Limited* v. *The Queen*, [1975] CTC 263 (FCTD), affirmed [1977] CTC 544 (FCA).

10. This test is discussed on p. 519, *infra*. See also Peter W. HOGG, *Notes on Income Tax*, 2nd ed. (1979) chap. 8:21, Osgoode Hall Law School, York University, Toronto.

11. H.K. WANG, "The 'Residence' of Companies in the Income Tax Acts", (1940) 22 *J. Comp. Leg. and Int'l Law* 166, 167.

II. COMMON LAW ORIGINS AND GENERAL PRINCIPLES OF CORPORATE RESIDENCE

"At common law every human being is a legal person; a group of persons is, however, not personified in our law and can therefore, at common law, take no part in legal transactions... The state, however, can confer legal personality upon a group of individuals so that it becomes a legal *persona* apart from the individuals comprising it. Such a *persona* is, in the Anglo-Saxon jurisdictions based on the common law, termed a corporation"[12].

Because a corporation is an artificial person which will pay tax on its global income on the basis of its residence, it is necessary to select what residence will be imputed to the company. A number of possibilities present themselves. For instance, since a corporation is made up of shareholders, one might reasonably think that the place where this group of individuals meets would be the residence of the company. But that is not so: as Farnsworth added, "it is not the country where the stockholders meet that is determinative but the place where its chief operations are in fact controlled, managed, and directed, i.e. where the directors meet to transact their business, exercise their powers and control the activities of the company".

The notion that the location of shareholders' meetings might be a criterion for the residence of the company itself was raised in *The American Thread Co.* v. *Joyce*[13], where Lord Justice Buckley wrote:

"The shareholders can no doubt by virtue of their votes control the corporation; they can compel the directors — who are not properly described as their servants but who are the managing partners in the concern — they can compel them to do their will but it does not follow that the corporators are managing the concern. The contrary is the truth; they are not. It is the directors who are managing the affairs of the corporation..."[14]

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12. A. FARNSWORTH, *The Residence and Domicil of Corporations*, (1939) 53, 61, Butterworth & Co. Ltd., London. References omitted.

13. (1913) 6 TC 1 (KBD & CA), affirmed (1913) 6 TC 163 (HL).

14. *Id.*, 32. This view was not new. A similar opinion was expressed by Lord Davey in the earlier case of *The San Paulo (Brazilian) Railway Company, Limited* v. *Carter*, [1896] AC 31, 43 (HL), where he held that it was clear "that the direction and supreme control of the... company's business is vested in the board of directors in London, who appoint the agents and officials abroad, and either by general orders or by particular directions control or may control their duties, remuneration, and conduct, and to whom any question of policy or any contract or other matter may... be referred for their decision. The business is therefore in very truth carried on, in, and from the United Kingdom...". In the same case, p. 41, Lord Watson wrote that "the directors... are vested with the sole rights to manage and control... [they are] for all purposes of administration and management... the company itself". In Canada, subsection 97(1) of the *Canada Business Corporations Act*, S.C. 1974-75, chapter 33, as amended,

Another starting point might well have been to assume that a company was resident solely at its registered office or in the country where it was incorporated. This, however, was not how the definition of corporate residence evolved. As early as 1872, the English Court of Queen's Bench, in *Newby* v. *Von Oppen and The Colts Patent Firearms Manufacturing Company*[15], concluded that because an American company actually had a place of business in London and traded there that it "does, for many purposes, reside both in England and in its own country"[16]. Just two years later, in the case of *A.G.* v. *Alexander and Others*[17], the same notion was again advanced, linking corporate residence to the place where business was carried on. The issue was whether a banking corporation, the Imperial Ottoman Bank, established as a state bank for the Ottoman Empire with its seat fixed at Constantinople, was resident in England and therefore liable to English income tax on *all* its profits (*i.e.* from France, Turkey, etc.), as opposed to only those profits realized by the branch in London. Baron Amphlett could not imagine that dual residence might be possible for either an individual or a corporation; indeed, he wrote, "this would be attended with... monstrous injustice... how can a foreign corporation be said to reside within the kingdom for no other reason than that it carries on business there?"[18]. He continued:

> "What, then, is the reasonable meaning of a corporation residing anywhere? It appears to me that it is this, that a corporation may be said to reside wherever it has its seat. Now, here, any one looking, not only at the language of the concession which establishes the bank abroad, but at the duties which it has to discharge, would, I think, hesitate to say that this bank, which exists only as a corporation in Turkey... and which has its seat in Constantinople, resides in the United Kingdom"[19].

Commenting on this case, Farnsworth thought it was "probable that the decision was erroneous in the light of later decisions enunciating the doctrine of control (*i.e.* the management committee of the Bank met regularly in London) and this is emphasized by the Court's rejection in the *Cesena* and *Calcutta* cases of the Crown's plea for registration as a sole test of residence, which was based on the

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provides as follows: "Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation".

15. (1872) LR 5 QBD 293.
16. *Id.*, 295.
17. (1874) LR 10 Ex. 20.
18. *Id.*, 34.
19. *Ibid.*

decision in *A.G.* v. *Alexander*"[20]. Rather than saying *Alexander* was wrongly decided, might the better view not be to see it as the state of the law as it existed at the time? Dual residence for a corporation was not to be dealt with in England for another 50 years[21], and many more years were to elapse after that before bilateral tax conventions would be entered into to mitigate the injustice which Baron Amphlett had foreseen.

The general principle of "control" as a test for corporate residence was first enunciated in *The Calcutta Jute Mills Company, Limited* v. *Nicholson*[22] and *The Cesena Sulphur Company, Limited* v. *Nicholson* cases[23]; both were heard on the same day. It was in these cases that the correlation between the place where the directing and controlling power is exercised and corporate residence took a firm hold. Both companies were registered in the United Kingdom under the *Joint Stock Companies Acts 1862 and 1867*. In the *Calcutta* case, all company property and manufacturing were in India; the directors met, declared dividends and controlled the finances of the company in London where the registered offices were located. The latter was also true in the *Cesena* case, but its business was carried on in Italy. The Cesena Sulphur Company was, however, also registered in Italy and its main books and bank accounts were there. Both companies were held to be resident in the United Kingdom, and both holdings were based on the doctrine of control.

Chief Baron Kelly crafted his judgments carefully; he was not unaware of their import. He wrote that "we have very carefully considered these cases, and the great principles of the law upon which we think they ought to be decided..."[24]; the Court must, in cases such as these, "look at the principles of the law... look at what decisions have been pronounced... and, above all,... look to the precise terms and the real meaning of every word of the... Act... upon which [these] cases must be decided"[25]. Kelly C.B. set the stage carefully for *control*

20. A. FARNSWORTH, *The Residence and Domicil of Corporations*, (1939) 89, 90, Butterworth & Co. Ltd., London. *Cesena* and *Calcutta* are discussed *infra*.

21. See *Swedish Central Railway Company, Limited* v. *Thompson*, [1935] AC 495 (HL). This case decided that control may be divided equally between two countries so that a corporation, like an individual, can, for tax purposes, be resident simultaneously in both countries. For a detailed discussion of the case and dual residence generally see pp. 526 and ff., *infra*.

22. (1876) 1 TC 83 (Ex.D).

23. (1876) 1 TC 88 (Ex.D).

24. *Id.*, 92.

25. *Ibid.*

to emerge as the general principle of corporate residence and not merely just another factor to be considered. Clearly, his Lordship was committed to the control doctrine as the correct interpretation of residence for the purpose of the statute:

> "Therefore... if a company can be said to reside anywhere,... this... company undoubtedly, in my opinion, resides at the office or place of dwelling... where the directors meet... where they transact their business and exercise the powers conferred upon them by the laws of the country and by the articles of association"[26].

The Chief Baron also dealt with the troubling fact in the *Calcutta* case that its entire business was carried on in India by reasserting that the company was, nevertheless, "wholly and exclusively under the authority of the governing body in this country..."[27]. With regard to the policy behind the rule, Chief Baron Kelly wrote that "if a foreigner residing abroad, and having no property, or interest in this country... thinks fit to come and invest his money in this country, and so to obtain the broad shield of protection of the law to his property, he must take it with the burdens belonging to it"[28].

The concurring opinion of Baron Huddleston drew the analogy between a company and an individual. He pointed out that the word "residence" is "founded upon the habits and relations of a natural man, and is therefore inapplicable to the artificial and legal person whom we call a corporation"[29]. His Lordship continued:

> "But for the purpose of giving effect to the words of the Legislature an artificial residence must be assigned to this artificial person, and one formed on the analogy of natural persons. You do not find any very great difficulty in defining what is the residence of an individual; it is where he sleeps and lives. We understand perfectly well what is the residence of a natural person. Then what is the residence of this artificial person? I think... that the residence of an artificial person... must be considered to be where he carried on his business, where the real trade and business is carried on"[30].

Later in his judgment, Baron Huddleston clarified further what he meant; he alluded to a German word (but without naming it) meaning "the middle point of the business", he inserted the French term "le centre de l'Entreprise" — all by way of illuminating the

26. *Id.*, 96.
27. *Id.*, 101.
28. *Id.*, 102.
29. *Id.*, 103.
30. *Ibid.* The argument was advanced by the Attorney General that the place of registration of a company determined its residence. Baron Huddleston rejected this, writing, at p. 104, that the "birth is not conclusive of the

notion which was to become known as "central management and control".

The following year, in *The Imperial Continental Gas Association* v. *Nicholson*[31], the same issue arose and the same two judges again enunciated the principles they had stated in *Cesena* and *Calcutta*. Baron Huddleston was very clear. He held that the "business is carried on at the place where the orders emanate. That is the central point where the business is carried on, where the directors meet..."[32].

The general principle evolved and was strengthened case by case. Lord Halsbury, in *The San Paulo (Brazilian) Railway Company, Limited* v. *Carter*[33], summarized the common law to that time:

> "[T]he locality of the goods or the land which are the subjects of the trade [is] in a certain sense the place where the trade is carried on... But there is another sense, in which the conduct and management, the head and brain of the trading adventure, are situated in a place different from that in which the corporeal subjects of trading are to be found... but the form of trading can make no difference. If it were a mine, as in the *Cesena Case*, or a jute mill, equally with a railway, the person who governs the whole commercial adventure... who, in the strictest sense, makes the profits by his skill or industry, however distant may be the field of his adventure, is the person who is trading".

As we can see, the test which was adopted — by analogy to a natural person, for a company cannot actually "reside" anywhere — was where the business of the company is effectively managed and directed. This test, however, was always applied to corporations incorporated in England; U.K. incorporation might, therefore, have been inferred to be a requisite of residence. This inference, if it did exist, was dispelled and the paramount importance of control was established beyond doubt in the leading case of *DeBeers Consolidated Mines, Limited* v. *Howe*[34].

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residence... [t]aking the analogy between a natural and an artificial person, in the case of corporation you say that the place of its registration is the place of its birth; but it is not because it is the place of its birth that the residence must be there; it is a fact which you must take in connexion with all the other facts, and if you find that it is registered in a particular country, and acts in that country, and has its office in that country, and receives dividends in that country, you may say that those are all acts, coupled with the registration, which lead you to the conclusion that that country is the seat of its business".

31. (1877) 1 TC 138 (Ex.D).
32. *Id.*, 147.
33. [1896] AC 31, 38 (HL).
34. [1906] AC 455 (HL). See also *The New Zealand Shipping Company Limited* v. *Thew*, (1922) 8 TC 208 (HL), and *Egyptian Delta Land and Investment Co. Ltd.* v. *Todd*, (1926) 14 TC 119 (KB), (1927) 14 TC 126 (CA), (1928) 14 TC 138 (HL).

III. CONTROL: DE FACTO OR DE JURE?

A. Central Management and Control

Thirty years of case-law culminated in the definitive common law test of corporate residence: central management and control — "control" meaning *de facto* control. This fundamental rule was laid down by the House of Lords in *DeBeers*[35], which concerned a South African company whose mining operations were carried on solely in South Africa, but whose board of directors, which made all major policy decisions, met and resided in England. The House of Lords decided that the company was resident in England, upholding the validity of the U.K. tax assessment:

> "[A] company resides for purposes of income tax where its real business is carried on... I regard that as the true rule, and the real business is carried on where the central management and control actually abides... This is a pure question of fact to be determined, not according to the construction of this or that regulation or bye-law, but upon a scrutiny of the course of business and trading"[36].

B. Place of Incorporation: Is it Relevant?

The principles of the judicial formula for ascertaining corporate residence apply to domestic and foreign-incorporated companies alike. The Egyptian Delta Land and Investment Company was incorporated in England, yet the House of Lords found it to be resident in Egypt because all shareholders meetings, directors' meetings, preparation and auditing of accounts — the central management and control — was located in Cairo[37]. As a general rule, then, the place of registration or incorporation of a company, although a factor in deciding where control is situated, is by no means conclusive of its place of residence[38]. In an early Canadian case, *British Columbia*

35. *Ibid.*

36. *Id.*, 458, *per* Lord Loreburn. The first case in which a foreign-registered company was held resident in the U.K. was *Goerz & Co.* v. *Bell*, [1904] 2 KB 136.

37. *Egyptian Delta Land and Investment Company Ltd.* v. *Todd*, [1929] AC 1.

38. See, for instance, *Cesena Sulphur Company, Limited* v. *Nicholson*, 1 TC 88, 104, where Huddleston B. remarked that registration is only a circumstance; it "is a fact which you must take in connection with all the other facts...". This case is discussed in greater detail at p. 516, *supra*.

Electric Railway Company, Limited v. *The King*[39], a company incorporated in the United Kingdom, but whose operations and management meetings were in Canada, was held, for tax purposes, to be resident in Canada.

At a 1961 meeting of the Canadian Tax Foundation, R. Stapells, Q.C., said that as this case "was decided by the Privy Council, we can take it that the basic law of Canada on corporate residence is that established by the House of Lords..."[40]. Similarly, in an editorial note on the case, it was written that this judgment is important because it was the first "arising out of litigation based upon the Canadian taxing statute to give any indication that the legal principles developed by the English Courts under the English Statute have application to the question of corporate residence under the Canadian Act"[41].

A Canadian court did subscribe to the *de facto* control test in *Yamaska Steamship Company Limited* v. *M.N.R.*[42]. In his reasons for judgment, R.S.W. Fordham, Q.C., wrote that this case was governed by the reasoning found in *Unit Construction Co. Ltd.* v. *Bullock*[43]. The features of *de facto* and *de jure* control and management were similar in the two cases. In *Unit Construction*, the appellant was a wholly-owned subsidiary of a company resident in England which had made payments to wholly-owned subsidiaries which were incorporated in Kenya and carried on business entirely outside the U.K. It was in the appellant's interest that the Kenyan companies be resident in the United Kingdom. The articles of association of the Kenyan companies provided expressly that their meetings could be held anywhere *except* in the United Kingdom. The Kenyan subsidiaries suffered financial difficulties and their management was taken over by the parent company; henceforth, all decisions regarding the subsidiaries were made by the directors of the parent company in London. By the articles of association, directors could not meet in the United Kingdom, but in fact they did. Thus, *de facto* control conflicted with *de jure* control.

The circumstances in *Yamaska Steamship* were similar to those in *Unit Construction*, *supra*. Although the company was incorporated in

39. [1946] CTC 224 (PC).
40. Report of Proceedings, Fifteenth Annual Tax Conference, Canadian Tax Foundation, (1961) 235, 242.
41. [1946] CTC 224, 225 (PC).
42. (1961) 28 Tax ABC 187.
43. [1960] AC 351 (HL).

Canada, its directors held no meetings and performed only minor clerical functions. All management decisions were made by an agent for the principal shareholder in the United Kingdom. Mr. Fordham wrote that "*de facto* management was exercised, beyond any shadow of doubt, from England. Merely a *de jure* control prevailed in Canada"[44]. The company was, therefore, not resident in Canada.

In the *Unit Construction* judgment, on which Mr. Fordham relied entirely, Lord Radcliffe reasoned that to look only to constitutional, and therefore authorized, management and control would be wrong and would destroy the common law test that had been based on actual fact[45]. Not only did Lord Radcliffe view this as wrong, but also as undesirable:

> "Ought we, then, to adopt this principle that evidence of what has happened in fact must be excluded by a rule of law if what has been done is inconsistent with the regulations of a company? In my opinion, it would be wrong to do so... Companies could be equipped with the most comprehensive sets of constitutions providing for management to be located in this or that selected taxing jurisdiction, and, however much the written requirements were in fact departed from for reasons of convenience or otherwise, all efforts to establish the true facts relating to the actual seat of management would founder on the ground that what had been done was merely 'unconstitutional'. I do not believe that this would conduce to the health of revenue administration. I think it much better to adhere to the approach laid down... in the *DeBeers* case... If this makes too elaborate a test, the proposed alternative would be altogether too simple..."[46]

The potential relevance of this in Canada is discussed by Gordon C. Bale in *The Basis of Taxation*[47], where he writes that the *de facto* control test "would permit Canada to tax the foreign earnings of foreign incorporated subsidiaries where their boards of directors simply implement policy decisions made by the Canadian parent company. The foreign incorporated subsidiary would be resident in Canada and taxable on its world income"[48].

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44. *Yamaska Steamship Company Limited* v. *M.N.R.*, (1961) 28 Tax ABC 187, 189.

45. [1960] AC 351, 369 (HL).

46. *Id.*, 370.

47. In *Canadian Taxation*, (1981) edited by Hansen, Krishna and Rendall, 21, Richard De Boo Limited, Toronto.

48. *Id.*, 46. Bale points out that because it was in the interest of the appellant company in *Unit Construction* that its subsidiaries should be resident in the U.K., the company provided all the necessary evidence to prove that it was. Conversely, if a Canadian parent company was actually controlling a

C. Precedence of the De Jure Test?

Although the *de facto* control test was followed unreservedly in the *Yamaska Steamship* case, subsequent Canadian decisions have, if not completely rejected the test, at least blurred it with a *de jure* test.

Thus, in *Sifneos* v. *M.N.R.*[49], the facts, as set out in the headnote, were as follows:

> "In issue was whether the company's 'central management and control' was exercised in Canada... or... overseas... [T]he directors... were resident in Canada... the directors' meetings were held in Canada... some banking and chequing were done in Canada... [T]he appellant contended that the directors took their instructions from overseas where the real management was exercised".

Roland St-Onge held that where the directors were, the management was; he did not go beyond *de jure* control of a company to consider a *de facto* control analysis. He distinguished the *DeBeers* and *Unit Construction* cases and said that the *Yamaska* case "does not help because of its various dissimilarities to the present case"[50]. Later in the judgment he wrote that one "should not be misled by appearances whereby the power behind the throne seems to originate in another country. They are not really powerful if they cannot act according to the laws of this country. Otherwise, the company would be completely useless. *Only an exercise of authority within the framework of the constitution of a company should matter*"[51].

The facts relating to the board of directors in *Bedford Overseas Freighters Limited* v. *M.N.R.*[52] and *Zehnder and Company* v. *M.N.R.*[53] are very similar to those in *Sifneos*. In *Bedford*, the Minister contended "that the directors' activities in Canada were purely formal, procedural and clerical and that no substantial element of management and control was actually exercised in Canada"[54]. Kerr J. held that "the management of the business of the company and the controlling power

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subsidiary and the Department of National Revenue were trying to prove it, there would probably be great difficulty in gathering such evidence. Might this not have been what led to Span, the subsidiary of Dominion Bridge, being held to be a sham rather than a Canadian resident in *Dominion Bridge Company Limited* v. *The Queen*, [1975] CTC 263 (FCTD)?

49. [1968] Tax ABC 652.

50. *Id.*, 660.

51. *Id.*, 661; emphasis added.

52. [1970] CTC 69 (Ex.Ct.).

53. [1970] CTC 85 (Ex.Ct.).

54. *Bedford Overseas Freighters Limited* v. *M.N.R.*, [1970] CTC 69 (Ex.Ct.).

and authority over its affairs were vested in its Canadian directors and they exercised that power and authority in Canada, albeit in large measure to carry out... instructions and policy decisions made elsewhere..."[55].

Bale wrote that it is not unfair to say that in *Sifneos*, *Zehnder* and *Bedford Overseas Freighters* "only lip service was paid to the idea that residence is where control actually abides as the cases seem to turn on where the directors were resident and met even though they simply implemented policy decisions made abroad"[56]. It is difficult to speculate why the cases were decided this way. One explanation might be simply that both *Bedford* and *Zehnder* were decided by the same judge and may be considered anomalous. Pyrcz wrote that "while Kerr J. voiced an acceptance of the *de facto* control test, he in effect reverted to a *de jure* test which had been expressly disapproved of by the House of Lords"[57]. To this one might respond that Canadian jurisprudence is taking time to develop, and does so in its own direction.

For most of this century, the only authorities were those from the United Kingdom. In deciding *Zehnder*, however, Kerr J. followed his own holding in *Bedford*. In a careful reading of these cases, "the difficulties of establishing the distinction between *de jure* and *de facto* control are evident. The decisions in these cases seem to indicate that Canadian courts will consider control to be exercised by the directors of a company who follow *de jure* requirements even though they act in accordance with the expressed wishes of a controlling shareholder"[58]. It should be borne in mind, however, that in *Unit Construction* control was clearly exercised by *directors*, whereas in *Bedford* a foreign *shareholder* "controlled" the directors, who carried out his wishes in Canada. Nevertheless, while Marchessini, the foreign shareholder, "made the major decisions", and Mathers, a Canadian director and president, "did what Marchessini instructed him to do"[59], the directors did carry out whatever management was necessary in Canada. Thus, as the judge noted, Mathers attended to the payment of mortgage interest, he dealt on behalf of Bedford with the Foreign Exchange

55. *Id.*, 84.

56. Gordon C. BALE, *The Basis of Taxation*, in *Canadian Taxation*, (1981) edited by Hansen, Krishna and Rendall, 21, 47, Richard De Boo Limited, Toronto.

57. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 380.

58. AIKMAN and AMIGHETTI, in *Income Taxation in Canada*, Vol. 1, no. 15,291 (looseleaf service), Prentice-Hall Canada Inc., Toronto.

59. [1970] CTC 69, 76.

Control Board, he obtained the approval of the Canadian Maritime Commission to change the name of vessels, and he engaged auditors and solicitors for Bedford in Halifax and paid them for their services.

The judge acknowledged that "the management and control of a company can be actually exercised otherwise than by its directors and otherwise than under or according to the authority of its constitution as, for example, in *Unit Construction Co. Ltd.* v. *Bullock*"[60]. But here the facts were different, and hence the conclusion that Bedford resided in Canada.

With respect, the result is not entirely convincing, and one is tempted to suggest that other factors left their mark. For instance, Bedford did not pay tax anywhere else. It would not be unreasonable, therefore, to find liability in Canada. Then, too, there is the well-established notion that only directors — and this quite to the exclusion of shareholders — "run" the company. Judges firmly subscribe to this view, and despite Mathers' testimony that "the time that he devoted to Bedford was about 25 hours per year for the initial years and less in the later years"[61], the acts of administration set out above were seized upon by the Court to promulgate the traditional doctrine that directors manage the company, and that in so doing they are not in any way bound to accept advice from shareholders, let alone obey them. That *in fact* a shareholder masterminded Bedford's operations could thus be overlooked, for to hold otherwise would have been to acknowledge that a shareholder actually managed the company — a situation which, in traditional wisdom, could not exist[62].

It is essential to be able to predict what tests are apt to be used when one is engaged in setting up an off-shore company. *Dominion Bridge Company Limited* v. *The Queen*[63] is a case in point. Had the Minister put forth a residence argument, claiming that Span, an off-shore subsidiary of Dominion Bridge Company Limited, was, in fact, managed and controlled by its parent company, that argument might

60. *Id.*, 83.

61. *Id.*, 80.

62. However, as was indicated in an Australian case, *Waterloo Pastoral Company Limited* v. *The Federal Commissioner of Taxation*, (1946) 72 CLR 262 (HC), there could be cases where directors meet in one location (Sydney) and residence is held to be at another location where some of the directors actually make the ultimate operating decisions. A review of all the evidence as to exercise of control would be necessary where directors' meetings were held in several locations.

63. [1975] CTC 263 (FCTD), affirmed [1977] CTC 554 (FCA). This case is also discussed at p. 513, *supra*.

have been met with a judgment holding that as *de jure* control was not in Canada, the subsidiary could not be resident in Canada. Span had a Bahamian board of directors and its business was conducted by officers of a trust company in Nassau. Mr. Justice Décary found that the business of Span was not its own but that of Dominion Bridge; he declared that Dominion Bridge "has camouflaged, disguised the operations of Span to make them appear as independent of the appellant's whereas, in fact, the evidence... is pervaded with the control, management and presence of the appellant, its sole client"[64]. Span's profits were, therefore, taxable in Canada in the hands of Dominion Bridge on the basis that the purpose of the incorporation of Span was a sham, as were its operations, which were really those of Dominion Bridge.

Victoria Insurance Company Limited v. *M.N.R.*[65], is a good example of an off-shore subsidiary of a Canadian company which was set up for legitimate business reasons and, because it was neither *de facto* nor *de jure* resident in Canada, avoided Canadian income tax. There are several interesting points in this case. In *Victoria*, the subsidiary was assessed for tax rather than its parent company, as had been done in *Dominion Bridge*, so its legitimacy was not in question. The Minister did, however, argue that control abides where directors exercise independent action and that simply holding meetings is not sufficient to meet this test. As Bale indicates in *Canadian Taxation*[66], the case "probably only illustrates the difficulty faced by the Minister in obtaining evidence about the degree of autonomy of a subsidiary". Bale also states that it is not clear "whether a *de jure* or a *de facto* approach to central management and control was adopted"[67]. I do not agree with this statement. Mr. St-Onge indicated clearly that the parent company succeeded in its intention to set up an off-shore company which would not be subject to tax in Canada, no matter which test was applied:

> "Except the fact that the appellant company was owned by a Canadian company, there is nothing to show that the latter controlled the former.
>
> It is clear that the control de jure was carried out in Nassau and there is no evidence to show that the control de facto was exercised by the owners of the appellant company... [T]he appellant company was incorporated in Nassau, had its head office and board meetings there and consequently its directors were

64. *Id.*, 270.

65. [1977] CTC 2443 (TRB).

66. Gordon C. BALE, *The Basis of Taxation*, in *Canadian Taxation*, (1981) edited by Hansen, Krishna and Rendall, 21, 49, Richard De Boo Limited, Toronto.

67. *Ibid.*

> protected by the laws of the Bahama Islands, were responsible to the company itself and were controlled by the rules and constitution of the appellant company and not by its shareholders.
>
> As may be seen, there is an independence of action and a sense of permanence great enough to say that the management and control... was in the Bahama Islands"[68].

The company had, apparently, done everything necessary to avoid being resident in Canada; it met the requirements of *both* the *de facto* and the *de jure* tests.

In a comment on this case, T.E. McDonnell wrote that the judgment in *Victoria* "would seem to be an affirmation of the principle that one looks to the place where the board of directors meets to exercise its management function in determining the location of management and control... They retain the *legal right* to exercise management and control even if all they do is rubber stamp decisions presented to them". McDonnell thought that because the directors in Nassau merely carried out the instructions of the company officers in Canada, "the basic management and control function was exercised from Canada. To hold otherwise exalts the formal exercise of the legal power of the board over the basic principle that it is *de facto* control which determines the question"[69].

It is my submission that this is precisely the state of the case law in Canada at present: the courts do exalt the "formal exercise of the legal power of the board". The recent Canadian cases have, as shown above, consistently preferred a *de jure* test of control over the *DeBeers de facto* test of central management and control in determining the residence of a corporation.

IV. DUAL RESIDENCE OF A CORPORATION: FRAGMENTATION OF "CENTRAL MANAGEMENT AND CONTROL"?

> "Until the epoch-making decision of the House of Lords in *Swedish Central Railway Co., Ltd.* v. *Thompson*[70] it had been assumed both by the Courts and by the Legislature that the residence of a corporation was unique... In *Swedish Central Railway Co., Ltd.* v. *Thompson*, it was held that a corporation, like an individual, could be resident in more than one country..."[71]

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68. *Victoria Insurance Company Limited* v. *M.N.R.*, [1977] CTC 2443, 2450 (TRB).

69. "Residence of Corporations — Whether Wholly Owned Bahamian Subsidiary of Canadian Company Resident in Canada", in the Current Cases feature, (1978) 26 *Can. Tax J.* 47, 49; emphasis added.

70. [1925] AC 495.

71. A. FARNSWORTH, *The Residence and Domicil of Corporations*, (1939) xxxiii, Butterworth and Co. Ltd., London.

The notion of dual residence of a corporation did not originate in the *Swedish Central Railway* case, although it was the first time it was the *ratio* of a case rather than *obiter*. Without the relief of a tax treaty or other legislation, dual residence may be an inevitable conclusion, particularly where the *DeBeers* test of central management and control is applied to establish corporate residence. The facts of individual cases, as stated by Lord Radcliffe, "have not always so arranged themselves as to make it possible to identify any one country as the seat of central management and control..."[72].

Before deciding as a matter of fact that the company did reside in two countries, it was necessary for Viscount Cave in *Swedish Central Railway*[73] to decide as a principle of law that a company, like an individual, could reside in more than one place at the same time. Although the subject had been broached in previous cases[74], it seems that the first direct approval of dual residence appears in *Goerz & Co.* v. *Bell*[75], where Channell J. said, in holding a foreign company resident in England, that "... *it is possible* — though I do not decide the question one way or the other — *that the company may have two residences*... That is clear in the case of a person, and I think the condition of things might be the same with regard to a company"[76]. In *The American Thread Company* v. *Joyce*[77], Lord Justice Buckley, in a discussion of corporate residence, wrote that a "corporation like an individual may have more than one place of residence"[78]. Viscount Cave (in *Swedish Central Railway*) interpreted the holding in *The Egyptian Hotels, Ltd.* v. *Mitchell*[79] to stand for the principle that a corporation could have dual residence. In that case, the company admitted that it resided in England for tax purposes, but the Court of Appeal (affirmed by the House of Lords) decided that the whole control and management of the company was in Egypt. His Lordship summed up his view of what the case stood for:

72. *Unit Construction Co. Ltd.* v. *Bullock*, [1960] AC 351, 366 (HL).

73. [1925] AC 495.

74. See, for example, *Cesena Sulphur Company* v. *Nicholson*, (1876) 1 TC 88 (Ex.D) and *Calcutta Jute Mills Company* v. *Nicholson*, (1876) 1 TC 83 (Ex.D); see also pp. 516 and ff., *supra*.

75. [1904] 2 KB 136.

76. *Id.*, 146; emphasis added.

77. (1913) 6 TC 1 (KBD & CA), affirmed (1913) 6 TC 163 (HL).

78. *Id.*, 31.

79. (1914) 6 TC 542 (HL).

> "It is noticeable that the facts... were sufficient according to the principle of the *DeBeers* case to establish residence in Egypt, so that, if a company can have but one residence — namely, the place where its control and management abides, it must have been held that the company being resident in Egypt was not resident here, and accordingly was not taxable at all; but no such suggestion was made... This being so, while the case does not expressly decide that a company may have two residences for income tax purposes, the decision appears to be inconsistent with any other view"[80].

Finally, Viscount Cave turned to Lord Wrenbury's speech in *Bradbury* v. *English Sewing Cotton Company, Limited*[81], and concluded that "it would appear that, while the authorities may not establish the possibility of a company having more than one residence for income tax purposes, they are at least not inconsistent with that view... I hold, therefore, that a company may, for income tax purposes, have a residence here as well as a residence abroad"[82].

The facts in *Swedish Central Railway*[83] were as follows: a company incorporated in England built a railway in Sweden and subsequently leased it out. Control and management of the company was transferred to Sweden. Although dividends were declared in Sweden, they were actually paid from the registered office in London. A majority of the House of Lords found that a company can have more than one residence. As Viscount Cave wrote, the "*central management and control of a company may be divided*, and it may 'keep house and do business' in more than one place; and if so, it may have more than one residence"[84]. Thus, as "it was hardly disputed that, assuming that a company can have two residences, there was sufficient material upon which that finding could be based"[85], it was held that the company was resident in two countries.

Having made this "epoch-making decision"[86], it fell to the courts to decide exactly how and when the central control and management of a company must be divided so as to have dual residence imputed to it. The *Swedish Central Railway* case had given little guidance in this regard. The case of *Egyptian Delta Land and Investment Co., Ltd.* v.

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80. *Swedish Central Railway Company Limited* v. *Thompson*, [1925] AC 495, 503 (HL); reference omitted.
81. [1923] AC 744, 767 (HL).
82. [1925] AC 495, 505.
83. [1925] AC 495.
84. *Id.*, 501; emphasis added.
85. *Id.*, 505.
86. See n. 71, *supra*.

Todd[87], also a decision of the House of Lords, based on very similar facts, qualified and restricted the *dicta* pronounced in *Swedish Central Railway* and gave rise to a great deal of academic and judicial comment[88]. In that case, the House of Lords rejected the contention that incorporation in England and the fulfillment of the statutory requirements of incorporation are alone sufficient to constitute residence when the administration of the company's affairs and its business are all carried on abroad. With seemingly disparate judgments of the same Court, it became necessary for other courts to attempt to bring into focus what facts would give rise to dual residence.

A 1940 Australian case, *Koitaki Rubber Estates Limited* v. *The Federal Commissioner of Taxation*[89], was the next reported Commonwealth case to consider the problem. The company claimed dual residence to avail itself of a tax exemption which would result from being resident in New South Wales and Papua as well. Mr. Justice Dixon held that the company was not resident in Papua and explained his view of what facts would amount to dual residence:

> "The matter must always be one of degree and residence may be constituted by a combination of various factors; but one factor to be looked for is the existence in the place claimed as a residence of *some part of the superior or directing authority* by means of which the affairs of the company are controlled"[90].

The holding enunciated in *Koitaki* was relied on in *Union Corporation, Ltd.* v. *Inland Revenue Commissioners*[91], where, although the companies admitted residence in the U.K., they claimed to be also resident abroad. In finding dual residence, the Court stated that "there must, in order to constitute residence, be not only some substantial business operations in any given country, but also present *some part of the superior and directing authority*... the question of the extent of the superior or directing authority required... is one of fact to be determined by the Special Commissioners"[92].

Although it seemed that the problem might have been solved, Pyrcz points out that the "abandonment of 'final and supreme

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87. (1926) 14 TC 119 (KB); (1927) 14 TC 126 (CA); (1928) 14 TC 138 (HL).

88. See, for instance, A. FARNSWORTH, *The Residence and Domicil of Corporations*, (1939) 197 *et seq.*, Butterworth and Co. Ltd., London; O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 382.

89. (1940) 64 CLR 15 (HC).

90. *Id.*, 19; emphasis added.

91. [1952] 1 All ER 646 (CA), affirmed [1953] 1 All ER 729 (HL).

92. *Id.*, 662; emphasis added.

authority' as the test of central management and control has been criticized often on the grounds that it does not accord with earlier decisions of the House of Lords"[93]. An example of earlier *dicta* is found in *San Paulo (Brazilian) Railway*[94], where Lord Davey wrote that "the direction and *supreme control* of the appellant company's business is vested in the board of directors in London... The business is therefore... carried on, in, and from the United Kingdom..."[95]. Similarly, in *The New Zealand Shipping Company Limited* v. *Thew*[96], Lord Buckmaster wrote that in the *DeBeers* case "it was stated that you must find out what is the *chief seat of* management..."[97]. Pyrcz submitted that "these cases clearly indicate that supreme and final authority is the test of central management and control and such authority must be divided to establish dual residence"[98].

The problem with Pyrcz's analysis, as I see it, is twofold. First, a precise division of "supreme and final authority" is virtually impossible to define, accomplish or ascertain. Second, and more fundamental, I suggest that these tests are incompatible with dual residence; there is a logical inconsistency. When these *dicta* were pronounced, as Farnsworth observed[99], it was assumed that the residence of a corporation was unique and that one could, therefore, always ascertain the very place of supreme and final authority or the chief seat of management; but this did not prove to be the case.

Many of the issues discussed above were reconciled in *Unit Construction Co. Ltd.* v. *Bullock*[100]. Though the case stood for the principle that it was the actual place of management and control of a company that determined its residence and not where its constitution stated it ought to be controlled, Lord Radcliffe made several observations on dual residence as well. His Lordship cited with approval Lord Loreburn's words in *DeBeers*[101] and said: "I do not know of any other test which has either been substituted for that of

93. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 384; references omitted.

94. [1896] AC 31 (HL).

95. *Id.*, 42; emphasis added.

96. (1922) 8 TC 208 (HL).

97. *Id.*, 220; emphasis added.

98. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 384.

99. See n. 71, *supra*.

100. [1960] AC 351 (HL). See also p. 520, *supra*.

101. See p. 511, *supra*.

central management and control, or has been defined with sufficient precision to be regarded as an acceptable alternative to it"[102]. He then noted that there have been, very exceptionally, circumstances in which the test simply could not be applied:

> "The facts of individual cases have not always so arranged themselves as to make it possible to identify any one country as the seat of central management and control at all. Though such instances must be rare, the management and control may be divided or even, at any rate in theory, peripatetic... *Union Corporation Ltd.* v. *Inland Revenue Commissioners* was of this kind. The facts were not such as to allow of Lord Loreburn's test being applied, and therefore some other basis of decision had to be selected. The solution chosen by the Court of Appeal appears to have been that residence arose in any country in which 'to a substantial degree' acts of controlling power and authority were exercised... It may perhaps still be open to question whether, where the facts are such that Lord Loreburn's test cannot be applied as a whole, the correct way of determining residence is... *to fragmentate his principle* and *establish a residence for tax purposes wherever the exercise of some portion of controlling power and authority can be identified*"[103].

His Lordship placed the *Swedish Central Railway* case in this same special class of case and suggested that the apparent discrepancies in that case and the *Egyptian Delta Land* case could best be dealt with by treating the two decisions "as if they were in effect one decision of the House and the speech of Viscount Sumner in the later case as affording an authoritative commentary on the significance of the earlier... If this is done, much of the difficulty disappears..."[104]. Therefore, if the facts were such as to make it impossible to identify a single country as the seat of central management and control, the inevitable conclusion must be that the company does have dual residence.

There are few Canadian cases dealing with dual residence. In *Crossley Carpets (Canada) Ltd.* v. *M.N.R.*[105], the company was incorporated in the United Kingdom and conducted its carpet distribution operations in Canada. The company was a subsidiary of an English company and its directors' meetings were held in England. However, apart from consulting the parent company regarding financing, the subsidiary managed its affairs on its own. The issue was whether the subsidiary was a non-resident corporation carrying on

102. [1960] AC 351, 366.

103. *Ibid.*; references omitted, emphasis added. For a comprehensive review and analysis of the case-law up to and including *Union Corporation Ltd.* v. *Inland Revenue Commissioners*, [1952] 1 All ER 646 (CA), see A. FARNSWORTH, (1952) 68 LQR 307.

104. *Id.*, 368.

105. [1968] CTC 570 (Ex.Ct.).

business in Canada and therefore subject to the branch tax. The Exchequer Court, confirming what had been said by the Assistant Chairman of the Tax Appeal Board, held that the exercise of paramount authority was divided between Canada and England and that the company was resident in both countries. In his decision at the Tax Appeal Board, Mr. Fordham, Q.C., had written that it "appears... that the appellant cannot be said... to reside wholly in Canada or wholly in England..."[106]. It would appear that these are the kinds of facts Lord Radcliffe referred to that have not "so arranged themselves as to make it possible to identify any one country as the seat of central management and control..."[107], which give rise to a special class of case wherein dual residence will apply.

Pyrcz, in a discussion of dual residence[108], concluded that "it can be seen that although a plethora of authority exists to support the proposition that a company may have more than one residence for tax purposes, the test of dual residence remains in an unsettled state"[109]. I agree with this, and I think one other point might be mentioned: with the recent reliance of Canadian courts on a *de jure* test of control, it is difficult to imagine circumstances in which dual residence might be held to exist[110].

V. DEEMED RESIDENCE

> "While the *DeBeers* test may have made sense in the late nineteenth and early twentieth centuries, the ever-increasing ease with which individuals today can move from continent to continent in a matter of hours has rendered it unacceptable as the sole nexus between a corporation and the Canadian taxation system"[111].

Even if the application of the common law tests for residence were absolutely clear, which they are not, they would still be unacceptable as the sole basis of corporate residence because, as indicated above, it is so simple today to change the place of management and control of a company and thereby change its residence.

106. 67 DTC 522, 524 (Tax ABC).
107. *Unit Construction Co. Ltd.* v. *Bullock*, [1960] AC 351, 366, See also p. 520, *supra*.
108. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 384.
109. *Id.*, 386.
110. For a full discussion of the application of this test, see pp. 526 and ff., *supra*.
111. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 386.

Before 1961, a Canadian company could become "non-resident" by placing its actual control and management with directors outside Canada. After accomplishing a series of manoeuvres, "[t]he company could then be wound up free from Canadian or foreign tax liability"[112]. In order to prevent this potential tax from slipping away, legislation was required; Canada could no longer rely on the long accepted, if sometimes irregularly applied, common law test of central management and control.

To stop Canadian incorporated companies from transferring their residence away from Canada by changing the seat of direction of the company's affairs, the *Income Tax Act* was amended to stipulate the particular circumstances when a company will be deemed to be resident in Canada throughout its taxation year[113]. Under paragraph 250(4)(a), all corporations incorporated in Canada after April 26, 1965 are resident in Canada; it is no longer necessary to ascertain where their central management and control abides. The company is actually taxed on the basis of its Canadian nationality and not its residence; the Canadian incorporation is sufficient to *deem* Canadian residence and,

112. *Ibid.*

113. Subsection 250(4) provides as follows:

> CORPORATION DEEMED RESIDENT
>
> (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 this Act 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 June 18, 1971, carried on business in any one particular country other than Canada, and
> (iv) during the period referred to in subparagraph (iii), paid dividends to its shareholders resident in Canada on which its shareholders paid tax to the government of the country referred to in subparagraph (iii),
>
> 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 (b) (i) to (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.

by statute, to bring the company within the purview of subsection 2(1) of the *Income Tax Act*, which subjects "every person resident in Canada" to an income tax. This was a major change in Canadian tax jurisdiction, but it was necessary to "counter surplus-stripping devices which relied on the ease with which the residence of a corporation could be changed"[114]. This "deeming" provision is further extended by paragraph 250(4)(b).

Corporations which were incorporated in Canada before April 27, 1965 are dealt with in paragraph 250(4)(c); they are deemed to be resident in Canada if, at any time after April 26, 1965, they were resident in Canada or *carried on business in Canada*. The Act does not specify any particular length of time a company need be resident (applying the common law test), or carry on business — apparently even a very short time is adequate to bestow deemed residence upon the corporation forever — regardless of where its central management and control actually abides[115].

The definition of "carrying on business" in Canada was at issue in *Orange Crush Products Co. Ltd.* v. *M.N.R.*[116], where the plaintiff was a company incorporated in Ontario. Although thus incorporated in Canada, the company's business consisted solely of acting as an intermediary in dealings between its American affiliates and their customers in Iraq. Because Orange Crush Products sold the products and received payments, the Tax Review Board held that the profits were realized in Canada and that the taxpayer, therefore, carried on business in Canada.

The reach of the tax collector has been extended much further than before and it can be seen "that Canada has totally adopted the nationality test as an ancillary basis for the taxation of the world income of a corporation incorporated in Canada after April 26, 1965 and has gone a very considerable distance towards adopting the nationality test in regard to corporations incorporated in Canada before April 27, 1965"[117]. Further, as Pyrcz observed,

> "[a]lthough the common law test has thus diminished in importance for the purposes of Canadian corporate taxation, this provision has nevertheless

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114. Gordon C. BALE, *The Basis of Taxation*, in *Canadian Taxation*, (1981) edited by Hansen, Krishna and Rendall, 21, 49, Richard De Boo Limited, Toronto.

115. AIKMAN and AMIGHETTI, in *Income Taxation in Canada*, Vol. 1, no. 15,295 (looseleaf service), Prentice-Hall Canada Inc., Toronto.

116. [1978] CTC 2737 (TRB).

117. Gordon C. BALE, *The Basis of Taxation*, in *Canadian Taxation*, (1981) edited by Hansen, Krishna and Rendall, 21, 49, Richard De Boo Limited, Toronto.

ensured its continuing relevance with respect to those companies incorporated in Canada prior to 27 April 1965 that have not carried on business here in 1965 or any subsequent year and to those companies incorporated abroad. Also, if a 'pre-1965' Canadian company is ever held to be a resident of Canada on the common law test, it will retain that status even though all vestiges of management and control are later removed"[118].

Another interesting extension of "carrying on business in Canada" is found in paragraph 253(b) of the *Income Tax Act*, which provides that where a non-resident person (a) made anything in Canada or, (b) solicited orders or offered anything for sale in Canada, he shall be deemed to have been carrying on business in Canada during that year[119]. As noted by F.E. LaBrie in *The Principles of Canadian Income Taxation*:

> "These provisions overrule common law reliance on the place of entry into, the place of performance of, or the place of payment under, business contracts from which profit is earned. A wide range of activity relating both to the production of anything in Canada and to the sale of anything in Canada is now deemed to be carrying on business in Canada"[120].

The 1896 decision of *Grainger and Son* v. *Gough*[121] is a classic example of a case dealing with the meaning of "carrying on business". The headnote in the report succinctly summarizes both the facts and the state of English law at the time:

> "A foreign merchant, who canvasses through agents in the United Kingdom for orders for the sale of his merchandise to customers in the United Kingdom, does not exercise a trade in the United Kingdom within the meaning of the Income Tax Acts, so long as all contracts for the sale and all deliveries of the merchandise to customers are made in a foreign country"[122].

Were *Grainger* to be heard today in Canada, the fact that a foreign merchant engaged agents in Canada to canvass for orders, to transmit

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118. O.A. PYRCZ, "The Basis of Canadian Corporate Taxation: Residence", (1973) 21 *Can. Tax J.* 374, 388.

119. Paragraph 253(b) provides as follows:

> 253. Where, in a taxation year, a non-resident person
>
> ...
>
> (b) solicited orders or offered anything for sale in Canada through an agent or servant whether the contract or transaction was to be completed inside or outside Canada or partly in and partly outside Canada, he shall be deemed, for the purposes of this Act, to have been carrying on business in Canada in the year.

120. (1965) 23 CCH Canadian Limited, Toronto.

121. [1896] AC 324 (HL).

122. *Ibid.*

the orders to him when obtained and sometimes to receive payment, would be sufficient to find the taxpayer to be carrying on business in Canada.

There have been some recent Canadian cases dealing with the interpretation of "carrying on business in Canada"[123], which are interesting to study because they tend to be decided not on their facts alone, but by weaving the facts, common law, the *Income Tax Act* and tax treaties together to form what appear to be reasonable results in the circumstances, but which do not, I suggest, form strong precedents because they are so fact-specific.

An excellent example of this kind of inter-weaving is to be found in the case of *Masri*[124], where four persons — all non-residents — acquired raw land in Montreal in 1955 and 1957 and sold it in that state from 1963 to 1967 for very large profits. One of the four had a brother in the real estate business in Montreal whose advice was sought and followed in negotiating these land deals. The appellant denied that he was carrying on business in Canada within paragraphs 2(2)(b) — now 2(3)(b) — and 139(7)(b) — now 253(b) — and argued that, in any event, he was exempt from taxation under Part 1 of the 1942 Canada-U.S. Tax Convention because he had no "permanent establishment" in Canada.

Dealing with each of these arguments in turn, the Court held that the appellant's participation in the Canadian real estate transactions did constitute "carrying on business in Canada" within paragraphs 2(2)(b) and 139(7)(b) of the *Income Tax Act*. Mr. Justice Heald carefully distinguished the case of *M.N.R.* v. *Tara Exploration and Development Company Limited*[125], where it was held that the taxpayer was not liable to Canadian tax under the same provisions of the Act being relied on in this case. Regarding the application of subsection 2(2)[126], his Lordship wrote:

123. See, for instance, *Masri* v. *M.N.R.*, [1973] CTC 448 (FCTD); *Sudden Valley Inc.* v. *The Queen*, [1976] CTC 297 (FCTD), affirmed [1976] CTC 775 (FCA); *Birmount Holdings Limited* v. *The Queen*, [1978] CTC 358 (FCA).

124. [1973] CTC 448 (FCTD).

125. [1970] CTC 557 (Ex.Ct.), affirmed [1973] CTC 328 (SCC).

126. The current version of this subsection — it is now 2(3) — provides as follows:

> TAX PAYABLE BY NON-RESIDENT PERSONS
>
> (3) Where a person who is not taxable under subsection (1) for a taxation year

> "A reading of the learned President's judgment [referring to the judgment of the Exchequer Court] in full makes it clear that he concluded as he did because in his case, the adventure was an isolated happening, no continuity of time or operations was involved. In the case at bar, we do not have an isolated adventure in the nature of trade as in *Tara* nor do we have a transaction that was not a part of the 'business' which the appellant was actually carrying on as in *Tara*.
>
> The facts of this case reveal a far different situation than the 'isolated transaction' situation of *Tara*"[127].

Having decided that the appellant was carrying on business in Canada within the meaning of subsection 2(2), the Court proceeded to examine the appellant's possible liability under subsection 139(7)[128]:

> "I have the view that paragraph 139(7)(b) is wide enough to cover the facts of this case where it is clear that the appellant, along with his partners, offered their real property for sale in Canada through real estate agents, knew that said agents were in fact advertising said property for sale by erecting 'for sale' signs on the property, paid their agents a commission for said sales"[129].

In the result, Heald J. found that the appellant was "carrying on business in Canada" within paragraphs 2(2)(b) and 139(7)(b), but he was exempted from tax on the profits from this business under the Canada-U.S. Tax treaty which was in force at the time and which supersedes any domestic tax legislation[130]. The Court found, on the facts, that the appellant did not have a "permanent establishment" in Canada as was required to bring someone within Article 1 of the Convention[131]. And so, Heald J. came to the ineluctable conclusion that the appellant was not liable to pay tax in Canada by virtue of the treaty; this appellant did, in fact, fall within the statutory provisions of the Act deeming residence in Canada, but somersaulted out of it by virtue of a tax treaty. It is to be noted, however, that had the Court

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(a) was employed in Canada,
(b) carried on 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 hereinafter required upon his taxable income earned in Canada for the year determined in accordance with Division D.

127. *Masri* v. *M.N.R.*, [1973] CTC 448, 452; references omitted.

128. Now paragraph 253(b). The next of this paragraph may be found in n. 119, supra.

129. *Masri* v. *M.N.R.*, [1973] CTC 448, 453.

130. See section 3 of the *Canada-U.S. Tax Convention Act*, 1943.

131. This Article reads: "An enterprise of one of the contracting States is not subject to taxation by the other contracting State... except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment in the latter State". Mr. Justice Heald outlined in some detail why

found that the appellant did have a permanent establishment in Canada, the treaty would not have applied and he would have been liable to pay the tax.

The next case on point, *Sudden Valley, Inc.* v. *The Queen*[132], is a good illustration of circumstances in which it would be advantageous from the point of view of tax liability for a company to be resident in Canada. Had the Court so found, Sudden Valley, Inc. would have been able to avoid a non-resident withholding tax applicable in the circumstances. The appellant in this case sought to have the deeming provision, paragraph 253(b), in conjunction with paragraph 2(3)(b), apply to its business affairs. The case actually hinged on a judicial interpretation of the words "soliciting orders" and whether or not an invitation to treat is carrying on business in Canada[133].

The facts of the case are as follows. Sudden Valley, Inc., an American company, was carrying on a sales promotion campaign in Vancouver to sell recreation lots in Seattle, Washington. Invitations were issued to visit the area; no mention was made of selling land. No offers were made in Canada; all sales contracts resulting from the advertising were completed in Seattle. The income which the Minister sought to tax was the interest payable on the balance of the purchase price of land purchased from the company by Canadian residents. The company claimed that it should be taxed as a company doing business in Canada and be subject to tax under paragraphs 2(3)(b) and 253(b) of the *Income Tax Act*.

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this appellant's business did not amount to a "permanent establishment" in Canada. He wrote, at p. 456 of the judgment, that "all management and executive decisions concerning appellant's business and, for that matter, the so-called partnership, were taken in New York; there were no employees in Canada; no office in Canada; no person resident in Canada having authority to contract or conduct business on behalf of the appellant or the partnership; all documentation regarding the acquisition and sale of the Canadian property was executed in New York; all instructions concerning the property came from New York; appellant and the partnership acted in Canada only through commission agents and brokers. Counsel for the respondent sought to attach significance to the fact that in the course of the Canadian land venture, the partners used the services of two town planners, a land surveyor, two brokers, two law firms and a notary. In my view, these circumstances strengthen my conviction that the appellant cannot be said to have a 'permanent establishment in Canada' because all of the above noted agents have one thing in common, they are independent agents, not employees, performing services on a fee for service basis". The subject of Canada's Tax conventions is dealt with in greater detail in this paper beginning at p. 541, *infra*.

132. [1976] CTC 297 (FCTD), affirmed [1976] CTC 775 (FCA).

133. See n. 119, *supra*.

At trial, Addy J. relied on *Grainger and Son* v. *Gough*[134], and wrote that, "[a]t common law, it seems very clear that the appellant was not carrying on business in Canada, for, to exercise trade in a jurisdiction, it is not sufficient to obtain orders within that jurisdiction if the sale is eventually made outside the jurisdiction..."[135]. Mr. Justice Addy continued: "Paragraph 253(b) of the current Act does change the common law to some extent and the matter therefore turns on whether the facts of the present case fall within the provisions of that section"[136]. Addy J. concluded by giving a narrow interpretation to the phrases "soliciting orders" and "offering anything for sale in Canada"; he applied basic contract law to the facts and wrote:

> "In considering whether the plaintiff was 'soliciting orders' in Canada, I do not agree that the words can be extended to include 'a mere invitation to treat'. Soliciting orders means that orders must be sought and attempts made to obtain them within the jurisdiction and the word 'offer', in my view, must be given its ordinary meaning in contract law, that is, a binding offer which, if accepted, would create a contract between the offeror and the offeree. This becomes all the more evident when one considers that the question at common law depended specifically on the existence of a binding contract and that the section was intended to amend the former common law to the effect that the contract need not be made within the jurisdiction (see *Partridge* v. *Crittenden*, [1968] 2 All ER 421 at 423 and 424)"[137].

This new wrinkle in the intepretation of paragraph 253(b) might have far-reaching consequences for corporations in border cities in the U.S. which advertise on radio, television or in the press in Canadian cities. The distinction between an "offer", an "offer to treat", and "solicitation" are not always easy to draw[138].

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134. [1896] AC 324 (HL), discussed on p. 535, *supra*.

135. *Sudden Valley Inc.* v. *The Queen*, [1976] CTC 297, 299 (FCTD).

136. *Id.*, 300.

137. *Ibid.* An editorial note on p. 297 of the report suggests that this interpretation "accords with the English rule whereby non-residents who merely seek or canvass business in the UK are not liable to tax. (See *Tichler* v. *Apthorpe*, 2 TC 89, and *Pommery and Greno* v. *Apthorpe*, 2 TC 182)". For further discussion see F.E. LABRIE, *The Principles of Canadian Taxation*, (1965) 22, 23, CCH Canadian Limited, Toronto.

138. See, for instance, G.H. TREITEL, *The Law of Contract*, 5th ed., (1979) 10, Stevens and Sons, London; S.M. WADDAMS, *The Law of Contracts*, (1977) 21, 22, Canada Law Book Limited, Toronto, and cases cited herein. The civil law, too, has its problems. As Jean PINEAU wrote in *Théorie des obligations*, (1979) 26, Les Éditions Thémis Inc., Montréal: "Quand l'offre est faite au public, un problème peut être soulevé: on a parfois, à se demander s'il s'agit d'une véritable offre de contracter ou simplement d'une offre de négocier, c'est-à-dire une invitation à engager des pourparlers. La distinction est importante: s'il

The next case of significance, *Birmount Holdings Limited* v. *The Queen*[139], raises a number of interesting points and the judgment goes full circle and decides it was unnecessary to call in aid any deeming provisions of the *Income Tax Act*. The only business of the appellant company was carried on in Canada and its central management and control were also in Canada: the company thus met the common law tests of corporate residence in Canada.

The issue in *Birmount* was whether the real estate profit resulting from a 1972 sale was taxable. The taxpayer contended that the company, though incorporated in Canada in 1960, was not resident in Canada. Immediately before acceptance of the offer for the land, the Canadian directors and nominee shareholders, acting for an individual resident in France, transferred their shares to Swiss nominees, who, as directors, formally accepted the offer. At trial, the transaction was held to be an adventure in the nature of trade assimilable to carrying on business in Canada within paragraph 250(4)(c), from which it followed that the corporation was deemed to be resident in Canada[140]. The Federal Court of Appeal affirmed the decision of the lower court, but for different reasons; it held that on the facts the corporation was resident in Canada without the assistance of subsection 250(4)(c), although it was in agreement with the trial judge that the company could be deemed to be resident in Canada in 1972 because it carried on business in Canada in that year.

Thus, as one fits together the bits and pieces of the provisions of the *Income Tax Act* which extend the common law meaning of residence, there can be no doubt that while their application clarifies some situations, there still remain circumstances in which one would be hard-pressed to give tax advice with any degree of certainty. The judgments in the recent *Birmount Holdings* case illustrate clearly that

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y a offre véritable, l'acceptation forme le contrat et le pollicitant est, alors, lié et tenu d'exécuter. S'il s'agit d'une simple invitation à engager des pourparlers, la réponse du destinataire ne sera pas une acceptation; ce pourra être une contre-proposition: le contrat ne sera pas formé, puisque les parties ne se seront pas encore entendues sur le contenu du contrat". See also cases cited by the author.

139. [1978] CTC 358 (FCA). The judgment at trial is reported at [1977] CTC 34 (FCTD).

140. *Birmount Holdings Limited* v. *The Queen*, [1977] CTC 34, 48 (FCTD). For an overview of deemed residence, see also *Canada Tax Service*, 2-302-2-309 (looseleaf service), Richard De Boo Limited, Toronto, and AIKMAN and AMIGHETTI, *Income Taxation in Canada*, Vol. 1, no. 15,305 (looseleaf service), Prentice-Hall Canada Inc., Toronto.

there are many ways of looking at the issue; unfortunately, though, these judgments offer little guidance for the future.

Finally, it should be noted that section 88.1 of the Act now sets out special rules for certain corporations which were incorporated in Canada, but which were granted, after August 28, 1980, articles of continuance in a jurisdiction outside Canada, or which, after the same date, became resident abroad.

VI. INTERNATIONAL TAX CONVENTIONS

> "In an ideal global tax system, there would be perfect tax harmony; this would be achieved if every part of the world possessed the identical taxing system and administered and interpreted the provisions of the system in exactly the same way. However, such a system seems as remote as Nirvana"[141].

The rationale behind international tax conventions is to mesh systems of taxation which might otherwise be contradictory. As Hogg points out, the treaty is the "principal mechanism for harmonising the tax systems of various countries so as to reduce double taxation and avoidance..."[142]. Most of the treaties, therefore, establish rules which will identify the place of residence of a potential taxpayer with some degree of certainty.

The definition of residence varies from treaty to treaty[143], but the Organization of Economic Development proposed a model convention in 1974 and several countries are attempting to conform to its provisions which, it is to be noted, often differ from similar provisions in the *Income Tax Act* and the common law on the point[144]. The new Canada-United States Tax Convention, which was signed in 1980 (but has not yet been ratified), covers "residence" extensively in Article IV.

141. Warren GROVER and Frank IACOBUCCI, editors, *Materials on Canadian Income Tax*, 4th ed., (1980) 132, Richard De Boo Limited, Toronto.

142. Peter W. HOGG, *Notes on Income Tax*, 2nd ed., (1979) chap. 8:34, Osgoode Hall Law School, York University, Toronto.

143. Canada now has tax treaties with more than 20 countries. In addition, other treaties have been negotiated, but not yet proclaimed, including a new treaty with the United States, which was signed in 1980. For a comprehensive discussion of these treaties, see Warren GROVER and Frank IACOBUCCI, editors, *Materials on Canadian Income Tax*, 4th ed., (1980) 132, Richard De Boo Limited, Toronto.

144. See, for instance, AIKMAN and AMIGHETTI, in *Income Taxation in Canada*, Vol. 1, no. 15,861 (looseleaf service), Prentice-Hall Canada Inc., Toronto, for a table which catalogues treaty-created differences from the general statutory rules for the taxation of residents and non-residents of many countries with which Canada has treaties.

In addition to attempting to conform to the O.E.C.D. model convention, the treaty clearly attempts to clarify and unravel some very complex notions about residence.

First, Article IV, paragraph 1, states that "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...". Second, in an attempt to avoid dual residence of companies, paragraph 3 provides that if, under paragraph 1, a company would have dual residence, then, "if it was created under the laws in force in a Contracting State, it shall be deemed to be a resident of that State". Third, Article V deals with "permanent establishment", which "means a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on". The term is then very fully defined in the succeeding paragraphs of Article V, and the income of a company is to be taxed in the country where it has its "permanent establishment".

On examining the provisions of this new treaty, it would appear that the Minister and the courts are given more guidance than before to ascertain just where a corporation is resident and, therefore, "who should render what unto a particular Caesar in this complex interdependent world made up of many nations... with multinational corporations carrying on business throughout most of the world"[145].

Canada's tax treaties are very important. As Hogg points out,

> "[t]hese treaties are not merely binding under international law; each one has been enacted into domestic Canadian law by a federal statute, and each implementing statute provides that the terms of the treaty are to take precedence over any inconsistent provisions of the Income Tax Act. In fact, the treaties do make significant changes in the Canadian law as it relates to tax questions which involve Canada and any country with which Canada has entered into a treaty"[146].

145. Gordon C. BALE, *The Basis of Taxation*, in *Canadian Taxation*, (1981) edited by Hansen, Krishna and Rendall, 21, 57, Richard De Boo Limited, Toronto.

146. Peter W. HOGG, *Notes on Income Tax*, 2nd ed., (1979) chap. 8:34, Osgoode Hall Law School, York University, Toronto. For an interesting discussion of the policy behind tax treaties, see Gérard COULOMBE, *Certain Policy Aspects of Canadian Tax Treaties*, 1976 Canadian Tax Foundation Conference Report, 290 where he writes that tax treaties "form an integral part of the international fiscal law applicable in any country and they are designed to complement the domestic international tax provisions — those relating to the taxation of foreign income and income of non-residents. These provisions are not only revenue-raising devices but they also serve the purpose of preserving the integrity of the domestic tax system and, simultaneously, of reconciling that system with

An article of a treaty may well be interpreted and applied differently by various courts. Thus, in the case of *Masri* v. *M.N.R.*[147], a company was exempted from tax under Article I of the existing Canada-U.S. Tax Convention. However, this was distinguished in the more recent judgment in *Estate of Heskel S. Abed* v. *The Queen*[148]. Masri and Abed were brothers-in-law, and although their tax assessments concerned, at least in part, the sale of the same parcel of land, Mr. Justice Pratte held in *Abed Estate* that the taxpayer, a non-resident of Canada, carried on business in Canada separate from any business in the United States and, therefore, the income from the Canadian business was not exempt from Canadian tax under the Canada-U.S. Tax Convention.

Counsel for the appellant had argued that Article I of the Convention "must be interpreted as providing that a resident of the United States who has no permanent establishment in Canada cannot be taxed in Canada on his commercial and industrial profits"[149]. But Pratte J. cited Article I of the Convention and subparagraphs 3(b) and (c) of the Protocol:

> "CANADA-U.S. RECIPROCAL TAX CONVENTION
>
> Art. I. (Industrial and commercial profits.) An enterprise of one of the contracting States is not subject to taxation by the other contracting States in respect of its industrial and commercial profits except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment in the latter State.
>
> No account shall be taken in determining the tax in one of the contracting States, or the mere purchase of merchandise effected therein by an enterprise of the other State.
>
> PROTOCOL
>
> 3. As used in this Convention:
>
> ...
>
> (b) the term 'enterprise' includes every form of undertaking, whether carried on by an individual, partnership, corporation or any other entity;

different systems of other countries. Quite obviously, this function of the domestic international tax provisions is somewhat more important in Canada than elsewhere because of the dependence of the Canadian economy on international trade and foreign investment".

147. [1973] CTC 48 (FCTD). This case is discussed in greater detail at p. 536, *supra*.

148. 82 DTC 6099 (FCA).

149. *Id.*, 6101.

(c) the term 'enterprise of one of the contracting States' means, as the case may be, 'United States enterprise' or 'Canadian enterprise' "[150].

His Lordship held, based on his interpretation of the above provisions, that Article I does not exempt U.S. residents from taxation in Canada on the commercial and industrial profits realized by them, if they do not have a permanent establishment in Canada. He explained:

"In order to be exempt from Canadian taxation under article I. a profit realized by a resident of the United States must be such that it can be considered as the profit of an enterprise or undertaking carried on in the United States. It follows that the resident of the United States who carries on business in Canada is not entitled to invoke the protection of article I of the Convention if he does not carry on an undertaking in the United States. It also follows, in my view, that article I of the Convention affords no protection to the United States resident who carries on at the same time an undertaking in the United States and a business in Canada, unless his Canadian business activities be so related to his United States undertaking as to be considered as part of that undertaking"[151].

Pratte J. agreed with the trial judge that, on the facts, Abed's business in Canada was in no way related to an undertaking carried on in the U.S. He believed that the different holding in *Masri* could be distinguished:

"This conclusion is not weakened by the fact that the Trial Division decided differently in the case of *Masri* v. *M.N.R.* (73 DTC 5367) where it had to consider the taxability of the profit realized on the sale of lot 128 by Gourdji Masri, one of Mr. Abed's associates. In that case, the Trial Division held that Mr. Masri was carrying on an undertaking in the United States and that the profit he had realized on the sale of lot 128 could be considered as a profit of that undertaking. I am not certain that I would have reached the same conclusion if I had had to decide that case. However, this does not matter. The issue to be resolved in this case is different: it is the taxability of the profits realized by Mr. Abed who, contrary to his associates and brother-in-law, never had any business activities in the United States"[152].

The case of *M.N.R.* v. *Tara Exploration and Development Company Limited*[153] is also of interest. There, as noted in *Materials on Canadian Income Tax*,

"[t]he Supreme Court of Canada (per Abbott J.) dismissed the Minister's appeal agreeing with the assumption that the profits were made from an adventure in the nature of trade but preferred to dispose of the appeal by applying the Canada-Ireland Income Tax Agreement. In this respect, the court

150. *Ibid.*

151. *Ibid.*

152. *Ibid.*

153. [1972] CTC 328 (SCC).

held that, since the profits were not attributable to a permanent establishment in Canada under Article 1 of the treaty, the appellant was not liable for tax"[154].

The provisions of a treaty were thus employed to resolve a practical problem and that, of course, is one of the reasons why they are there.

CONCLUSION

If any conclusion emerges from the discussion above, it is that a clear-cut definition of "residence" or "reside" has so far eluded Courts in the United Kingdom and Canada. As the Lord President, Lord Clyde, said in *Reid* v. *C.I.R.*[155]:

> "The expression 'resident in the United Kingdom' and the qualification of that expression implied in the word 'ordinarily' so resident are just about as wide and general and difficult to define with positive precision as any that could have been used. The result is to make the question of law become (as it were) so attenuated, and the field occupied by the questions of fact become so enlarged, as to make it difficult to say that a decision arrived at by the Commissioners with respect to a particular state of facts held proved by them, is wrong".

Lord Clyde dealt with an individual, but the rules (as discussed in the Introduction) apply with equal force to corporations.

A summary, then, of the rules of residence of corporations would, in broad outline, read like this: first, in virtue of subsection 250(4) of the *Income Tax Act* a company incorporated after April 26, 1965, is necessarily deemed to be resident in Canada; second, the residence of any corporation which does not come within the deeming provisions of the Act is determined by the location of the actual control and management of the corporation; and third, tax liability by reason of residence is further modified by the effect of tax treaties which, to an ever-expanding extent, are called in aid to resolve "international" situations.

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154. Warren GROVER and Frank IACOBUCCI, editors, *Materials on Canadian Income Tax*, 4th ed., (1980) 126, Richard De Boo Limited, Toronto.

155. (1926) 10 TC 673, 678 (Ct. of Sess., Scotland).

Fiscal residence is of great importance to individuals, corporations, trusts and estates, for it is on the basis of residence that an individual and, by analogy, a corporation, trust or estate pays income tax in Canada on global income. The Act is deficient in a definition of residence, and the case law is, in some instances, of minimal predictive value. Often, the dearth of judicial decisions leaves an even greater gap.

For the vast majority of "persons", the problem of residence simply does not arise because they are either deemed to be resident in Canada or their residence is readily apparent. In the case of an individual, a permanent home — a centre of vital interests — can usually be determined; the location of central management and control of a company is, more often than not, quite clear; and, because trusts and estates are normally designed with an eye to attracting as little tax as possible, their residence, too, is frequently obvious.

It is when the established guidelines cannot be ascertained that the courts must resolve the issue of residence, and this is done based on the particular facts of the case at bar. The outcome is rarely certain: residence is a murky area of tax law. The principles are clear, but their application, often, is not.