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The Bijural Revision Services Unit (Taxation and Comparative Law) of the Legislative Services Branch of the Department of Justice is pleased to keep you posted on the most recent harmonization and bijuralism news.

International

The OECD and the TCC Consider the Meaning of "beneficial owner"

The OECD is examining the concept beneficial ownership. On April 29, 2011, the OECD Committee on Fiscal Affairs invited "public comments on draft changes to the Commentary on Articles 10, 11 and 12 of the OECD Model Tax Convention, concerning the meaning of beneficial owner."[1] The proposals are set out in a 10 page document, *Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention - Discussion Draft* (the "OECD Proposals").[2] Comments submitted will be published on the OECD web site.

The OECD Proposals are a response to varying interpretations given by courts and tax administrations that increase the risk of double taxation and non-taxation. The proposals emphasize that the term "beneficial owner" was added to assist in the context of determining whether an amount was *paid to* a resident of a Contracting State, and that the expression "beneficial owner" must be interpreted in that context. The proposed revision to the Commentary also makes clear that the term "beneficial owner" was not intended to refer to any technical meaning under the domestic law of a given country and is not used in a narrow technical sense.[3]

By way of illustration, the OECD Proposals use the example of trustee of a discretionary trust that did not distribute to beneficiaries dividends earned by the trust in a given period. The trustee in these circumstances would be the beneficial owner of the dividends for purposes of Article 10 "notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership."[4] The OECD Proposals also provide that the recipient of dividends, interest payments, or royalties is the "beneficial owner" of said amounts for treaty purposes

> *(…) where he has the full right to use and enjoy … unconstrained by a contractual or legal obligation to pass the payment received to another person.*[5]

It is of interest to note that the OECD Proposals have already been brought to the attention of the Tax Court of Canada. On May 17th and 18th, the Tax Court heard the appeal of Velcro Canada Inc.,[6] with judgment being reserved. At issue is whether a resident of the Netherlands is the beneficial owner of royalties arising in Canada. The OECD Proposals were included in the appellant's Book of Authorities, with Velcro Canada's counsel arguing that Justice Rossiter should not rely on the proposed commentary, as it was not in force at the time of the transactions at

[1] http://www.oecd.org/document/1/0,3746,en_2649_33747_47652161_1_1_1_1,00.html
[2] http://www.oecd.org/dataoecd/49/35/47643872.pdf

[3] Ibid. at 3, proposed changes to Commentary on Article 10 (Dividends), paragraph 12.1.
[4] Ibid., n.1.
[5] Ibid. at 4 (proposed paragraph 12.4 (Dividends)), at 6 (proposed paragraph 10.2 (Interest)), and at 9 (proposed paragraph 4.3 (Royalties)).
[6] 2007-1806(IT)G. This case had been held in abeyance pending the final decision in the matter *The Queen v. Prévost Car*, 2009 FCA 57. See "Court of Appeal Rules in *Prévost Car Inc.*" *The Link*, No. 30 (April 2009) 1.

issue. For its part, the Crown relied on the comments of the Federal Court of Appeal in *Prévost Car* which favoured a more flexible approach, allowing later in time commentary to assist in treaty interpretation.[7]

The OECD Proposals reflect the recommendation of the Bijural Revision Services Unit in its 2008 submission to the Advisory Panel on Canada's System of International Taxation.[8] Our submission argued that an international meaning – not a domestic law meaning – was appropriate in interpreting "beneficial owner" in a treaty context. We pointed out that reliance on a domestic law meaning is problematic in that it creates the potential for a multiplicity of interpretations across the treaty network and real difficulty in jurisdictions having no concept of "beneficial owner." These difficulties are compounded in the Canadian bijural context. While the concept of beneficial owner has meaning in the common law provinces and territories, it is unknown to the civil law of Quebec. Bearing these difficulties in mind, the OECD Proposal which favours a uniform and international meaning is thus to be lauded.

Jurisprudence

Two Paths to the Same Destination

Justice Létourneau of the Federal Court of Appeal held in 2009 that there is "no antinomy between the principles of Quebec civil law and the so-called common law criteria used to characterize the legal nature of a work relationship between two parties."[9] However, two recent decisions of the Tax Court of Canada show that while some judges are prepared to accept the Federal Court of Appeal's message, at least one may not be.

Both decisions discussed here involve taxpayers named Bernier who were resident in Quebec and who exercised their employment in Quebec. In both cases, the taxpayers were found to be employees for purposes of the *Employment Insurance Act*.[10] Both decisions illustrate how employment status is established in very different factual situations. However, the focus here is not on the result, but rather on the apparent tension on the matter of the how one must approach the analysis of employment status under the laws of the Province of Quebec.

The earlier decision, *Bernier and Mongeau v. MNR*,[11] concerns employment status in the context of film and television program production. Here, Justice Archambault, who also rendered the Tax Court's decision in *Grimard*,[12] seems to express dissatisfaction with the approach of Justice Létourneau in *Grimard*. Justice Archambault points out that, in his decision in *Grimard*, he did not invoke common law principles, and outlines, at considerable length, why he did not do so.[13]

The other decision, rendered by Justice Hogan in *Bernier and Bernier v. MNR*,[14] concerned individuals providing after-hours cleaning services to commercial undertakings. Justice Hogan states,

> *[19] These factors were established and have been evolving under common law. The question that must be considered now is how important they are under civil law. Since section 8.1 of the Interpretation Act, R.S.C. 1985, c. 1-21, was enacted, it has been clear that the criteria from the Civil Code of Québec must be used to determine whether a contract of employment exists. Thus, are the common law criteria still relevant?*
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> *[20] The Federal Court of Appeal clearly explained how to apply those criteria in light of the Civil Code in two recent decisions: Grimard v. Canada, [2009] 4 F.C.R. 592, 2009 FCA 47, and NCJ Educational Services Ltd. v. Canada, 2009 FCA 131. The Court stated that, under the Civil Code, the contract of employment must be read in light of the*

[7] *Prévost Car*, ibid. at para. [9] *et seq*.
[8] See "Bijuralism and the Interpretation of International Agreements – Canada's System of International Taxation" *The Link*, No. 29 (October 2008) 1.
[9] *Grimard v. The Queen*, 2009 FCA 47 at para. 43.
[10] S.C. 1996, c.23, as amended.
[11] 2011 TCC 99.
[12] 2007 TCC 755.
[13] Supra note 1. At para. [49] *et seq*. Justice Archambault cites his article on the subject, "Contract of Employment Why *Wiebe Door Services Ltd.* Does Not Apply in Quebec and What Should Replace It" in *The Harmonization of Federal Legislation with Quebec Civil Law and Canadian Bijuralism: Second Collection of Studies in Tax Law* (2005), (Montreal: Association de planification fiscale et financière, 2005).
[14] 2011 TCC 156.

> *relevant provisions.[1]* [15]*According to the exhaustive analysis performed by the Federal Court of Appeal in the two decisions, direction and control over the work are a determinative factor in a contract of employment, but the other criteria established by the common law are also relevant because they provide indicia of subordination or supervision.*(…)

Neither of these decisions has been appealed.

The ITA Definition of "property" Casts a Wide Net

In *The Queen v. Haché*,[16] the Federal Court of Appeal held that Mr. Haché (the "Taxpayer") disposed of "property" when he agreed to abandon all privileges and rights associated with two fishing licences in the context of the 2000/2001 Fisheries Access Program. The Court found that the licences constituted a "right of any kind whatever" for purposes of the definition of "property" in the Income Tax Act (Canada).[17]

In so holding, the Federal Court of Appeal overturned the decision of the Tax Court of Canada. Justice Trudel distinguished *Manrell*,[18] finding that the rights relinquished by Mr. Haché "cannot be referred to as general and non-exclusive"[19] and were quite different from the granting of an undertaking not to compete that was at issue in *Manrell*.[20]

The Court then used the remainder of the judgment to consider the Tax Court's conclusion that the licences were no longer valid at the time of the agreement and thus could not constitute property. The Federal Court of Appeal disagreed, noting,

> *…the fact remains that the commercial reality in this industry is that licences will be renewed from one year to the next and that departmental policy will protect those who already hold licences. Indeed, as stated in Saulnier, the stability of the fishing industry depends on the MFO's predictable renewal of licences year after year (Saulnier at paragraph 14).*[21]

The Court observed that in his application for participation in the program, the Taxpayer described his permits and entered his claim in the column "Asking Price for full licence packet" and this,

> *…without any regard for any consideration whatsoever as to the validity of his licences. There is no doubt that the respondent, in my opinion, was then negotiating on "property" within the meaning of the ITA and that he was claiming sums as consideration for the disposition of a "right of any kind whatever."*[22]

Common Law Meaning of "Gift"

Two recent cases have held that no "gift" was established at common law. In *Maréchaux v. The Queen*,[23] at issue was access to the charitable donation tax credit for a $100,000 donation. Mr. Maréchaux participated in an arrangement whereby he made a cash outlay of $30,000 from his own funds (of which $10,000 was applied to the payment of fees, a security deposit and the purchase of insurance), and received an interest-free loan in an amount equal to 80% of the pledged gift. The insurance policy and security deposit were then assigned to the lender (within 16 days of the borrowing in M. Maréchaux's case), in full satisfaction of the loan. In these circumstances, Madam Justice Woods concluded that:

> *[42] Even if it is accepted that the appellant's participation in the Program was influenced primarily by a charitable motivation, this would not assist the appellant. Once it is determined that the appellant anticipated to receive, and did receive, a benefit in return for the Donation, there is no gift.*

The Federal Court of Appeal upheld this decision, approving the Tax Court's determination that

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[15] The note referenced in this extract reads as follows: "They are articles 1425, 1426, 2085 and 2099 of the Civil Code of Québec."

[16] 2011 FCA 104. The Taxpayer did not seek leave to appeal.

[17] Subsection 248(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supplement), hereinafter the "ITA." Unless otherwise stated, statutory references throughout are to the ITA.

[18] 2003 FCA 128.

[19] Ibid., para. [22].

[20] Ibid., para. [23].

[21] Ibid., para. [28]. In *Saulnier v. The Queen*, [2008] SCC 5, the Supreme Court of Canada concluded that fishing licences constituted property under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-13.

[22] Ibid., para. [41].

[23] 2009 TCC 587 (G), affirmed 2010 FCA 287.

having access to an $80,000 interest-free loan, repayable in 20 years' time, constituted a significant benefit for the taxpayer. On June 9, 2011, the Supreme Court of Canada dismissed Mr. Maréchaux's application for leave to appeal (docket #34073).

In the other decision, *McNamee v. McNamee*,[24] at issue was whether shares transferred from father to son could be excluded from the calculation of net family property on the basis that the shares were "acquired by gift or inheritance from a third person after the date of the marriage."[25] Ontario's Superior Court of Justice held that the purported gift was not in fact a gift for purposes of the *Family Law Act*. Of the six essential elements of gift identified by the Court, only two were satisfied. Among the conditions not fulfilled were the lack of acceptance by the donee (the donee was in fact not even aware of the gift) and the donor's failure to relinquish control of shares.

Rectification Achieved Under the Rules of the Civil Code of Québec

In *SMRQ c. Services environnementaux AES inc.*,[26] the Quebec Court of Appeal had to consider the effect of an error in the calculation of the adjusted cost base of certain shares exchanged in the context of a 1998 corporate reorganization. The error resulted in the realization of a taxable capital gain of $840,770.

The Quebec Superior Court granted the taxpayer's demand for rectification of the contract. The Deputy Minister of Revenue of Quebec (the "DMRQ") appealed this decision, criticizing the Superior Court for introducing to Quebec civil law the common law doctrine of equitable rectification.[27] The DMRQ also argued that even if the doctrine did apply, the judge erred in allowing the parties to modify their agreements of December 15, 1998, as those agreements properly reflected the parties' intention at the time.[28]

Justices Chamberland, Morissette, and Kasirer held that the Quebec Superior Court has authority to allow corrections to be made to a document setting out a contract in the event of divergence between the common intention of the parties and the intention set out in the document where (our translation) "the request is legitimate and necessary and the sought after correction does not affect the rights of third parties."[29] The Court also affirmed that this result is achieved in accordance with the civil law:

> *(our translation)*
> *[13] The Appellant's argument regarding the importation into civil law of the common law theory of « equitable rectification » does not hold. Quebec civil law already has all the tools necessary to allow, in certain circumstances, the common intention of the parties to a contract to be given effect where the drafting does not reflect this intention. It is not necessary, to arrive at this result, to call upon a theory which belongs another legal system.*

The DMRQ is seeking leave to appeal (Supreme Court of Canada docket #34235).

[24] 2010 ONSC 674.
[25] Subsection 4(2) of the *Family Law Act*, R.S.O. 1990, c.F.3.
[26] 2011 QCCA 394.
[27] Ibid., para. [7].
[28] Ibid.
[29] Ibid., para. [12]. At para. [21], the Court of Appeal states that the fisc suffers no prejudice by the correction as the applicable tax legislation envisages that the transaction could be structured to avoid immediate tax consequences, and furthermore that had the contract been drafted as the parties intended, there would have been no immediate tax consequences.