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Vern Krishna: Tax court complicates use of double taxation treaties



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You might have heard about that recent tax court case involving Conrad Black. Vern Krishna, Legal Post tax columnist and one of the leading tax lawyers in the country, thinks the court got it wrong. [Reuters](#)

Conrad Black suffered a legal loss when the Tax Court of Canada ordered that he must pay the Canadian government tax on 2002 income he earned while legally residing in the United Kingdom.

Lord Black is appealing the ruling (*Black v. The Queen*, 2014 TCC 12). Meanwhile, the case will create uncertainty for taxpayers who reside in more than one country and who thought there were in compliance with the rules.

The case concerns tax treaties, which are designed to protect taxpayers from double taxation of income or gains arising in one country and paid to residents of another country.

The concept of tax residence is the cornerstone of such treaties. Taxpayers living in more than one country will take care to structure their international affairs and transactions in ways to receive the benefits of these treaties.

A fundamental principle of bilateral income tax treaties is that a person can be a resident of only one of the partners for treaty purposes. Thus, the right to tax the taxpayer on his or her worldwide income is generally assigned only to the country where he or she is resident for treaty purposes.

For example, assume an individual, who has his only permanent home and social and economic ties in the United Kingdom, stays 183 days or more in Canada. The individual is deemed to be a resident of Canada and taxable on his worldwide income. Depending upon

U.K. domestic tax law, he could also be taxable as a resident in that country on the same income. Hence, there is potential for double taxation of the same income.

Article 4 of the Canada–U.K. Tax Convention, the treaty at issue in Lord Black’s case, resolves the dual residence problem through a hierarchy of “tiebreaker rules” that give only one of the two countries the primary right to tax. Article 4 deems an individual to be a resident of the country in which he has a permanent home available to him. If he has a permanent home available to him in both countries, he is deemed to be a resident of the country with which he has closer personal and economic relations, or has his habitual abode. Hence, in the above example, the individual would be considered a U.K. resident by virtue of his permanent home, and social and economic ties, in that country.

Tax treaties benefit both taxpayers and the tax authorities by promoting certainty and reducing compliance burdens. However, as there is no international tax court to adjudicate the interpretation of treaties, their proper functioning relies on the domestic tax authorities and courts of each country. In Canada, tax disputes initiate in the Tax Court of Canada. Unfortunately, the Conrad Black decision illustrates that the court’s creative interpretations can promote, rather than resolve, uncertainty for taxpayers and complicate compliance with tax rules.

In 2002, Lord Black, a Canadian resident for tax purposes, was also a resident and non-domiciliary of the United Kingdom – hence, a dual resident. As a resident of Canada, Lord Black filed his income tax return as required, declaring approximately \$808,000 of income from various offices and employment duties performed in Canada. However, as a dual resident, Lord Black quite legitimately claimed the protection of article 4 of the treaty, which deemed him to be a resident of the U.K. for treaty purposes. Thus, he would not be liable for Canadian tax on salary and benefits of up to \$5.1-million for duties performed outside Canada. (In addition to the taxability of his non-Canadian income, Lord Black disputes that he would owe tax on that full \$5.1-million.)

As a non-domiciliary – an arcane legal concept – Lord Black would not be taxable under U.K. domestic tax rules unless he remitted his income to, or received it in, the U.K. This exemption of unremitted foreign income is what makes the U.K. the best tax haven in the world for individuals who are resident “non-doms” – a fact well known to Russian oligarchs, Arab potentates, African and Asian dictators and their friends. To be sure, exemption implies a substantial revenue loss for the British treasury, but that is a matter of its domestic tax policy and of no concern to Canada. As he is legally entitled to do, Black arranged his financial affairs to minimize his global tax bill.

Black’s tax planning irked the Canada Revenue Agency. Thus, despite the tax treaty, the CRA assessed Lord Black under the Canadian Income Tax Act, claiming jurisdiction over his income earned outside Canada and not remitted to the U.K. The primary issue before the Tax Court was whether Black’s deemed residence in the U.K. precluded the CRA from assessing him on the excluded income under Canadian law.

The cardinal rule of treaty interpretation is that it shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. Treaties are to be interpreted liberally with a view to implementing their true intentions, but only in the context of the words used in the treaty. The tiebreaker rules in article 4 are deeming provisions – that is, conclusive presumptions of law, which assign jurisdiction based on residence to one or other of the treaty partners for treaty purposes. The article is a foundational principle for the “assign and classify” system of the OECD Model Convention, which Canada follows.

Nevertheless, after reviewing the literature and commentary on the model, which is written by revenue bureaucrats, the Tax Court concluded that the deeming provision gave no more than a “preference” for one country’s claim over the other, and did not constitute an override of Canadian domestic law. Hence, despite the tax treaty, Canada could tax Lord Black’s non-Canadian income!

The decision undermines the integrity of article 4 of all of Canada’s tax treaties and thwarts the fundamental purpose and role of the provision in the structure of tax treaties. Treaties are an integral part of Canadian tax law on which taxpayers rely to arrange their affairs.

The Lord Black decision creates uncertainty in tax law and increases the burden of compliance, both of which are issues of national importance.