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## Tax Treaty Cases, 1965-2008

David A. Ward and Stephen S. Ruby\*

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**KEYWORDS:** TAX LITIGATION ■ TREATIES

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### INTRODUCTION

Between 1965 and 2008, former Chief Justice Bowman participated in a number of tax treaty cases, either as counsel or as judge. This article reviews those cases and also refers, in the footnotes, to other court decisions or authorities in the same general area.

### BOWMAN AS COUNSEL

#### **Western Electric Company Inc. v. MNR<sup>1</sup>**

The first of the tax treaty cases is *Western Electric*. Donald Bowman together with Paul DioGuardi appeared for the minister and H. Heward Stikeman together with Peter Cumyn appeared for the taxpayer. The taxpayer, a subsidiary of American

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\* David A. Ward, now deceased, was formerly of Davies Ward Phillips & Vineberg, Toronto. Stephen S. Ruby is of the same firm (e-mail: sruby@dwvp.com).

1 69 DTC 5204 (Ex. Ct.), a decision of the Exchequer Court under the 1942 Canada-US tax treaty, *infra* note 3.

Telephone and Telegraph Company, was a resident of the United States with no permanent establishment in Canada and supplied confidential technical information to Northern Electric Co. Ltd. (then a subsidiary of Bell Canada) for fees based on a percentage of sales by Northern Electric. Northern Electric also paid royalties to the taxpayer under a separate patent licence agreement. It withheld Canadian tax of 15 percent on these royalty payments but did not withhold Canadian tax from the fees paid for the technical information. The issue was whether those fees constituted a “rent, royalty or a similar payment . . . for the use in Canada of property” under then paragraph 106(1)(d) (now subparagraph 212(1)(d)(i)) of the Income Tax Act.<sup>2</sup>

The taxpayer argued that the fees constituted “industrial and commercial profits” that were exempt from Canadian tax under the 1942 Canada-US treaty<sup>3</sup> because the taxpayer did not have a permanent establishment in Canada and because the fees were not “rentals or royalties for the use of . . . secret processes . . . and other like property” within the meaning of paragraph 6(a) of the 1956 protocol to the 1942 treaty. The essential argument of the taxpayer was that what was furnished to Northern Electric was intangible ideas, or “knowhow”; that these ideas were not secret processes or formulas but rather abstract knowledge or scientific lore; and that, because of their intangibility, they were not “property.” This argument was made to support the position that the payments in question were not rentals and royalties but were “industrial and commercial profits” as defined in article II of the treaty. Essentially, the taxpayer argued that it was providing Northern Electric with knowledge; knowledge is not property and cannot be either sold or licensed. Put another way, it was argued that what was provided was a technical service and that service was provided in the United States through the provision of drawings, and specifications recorded on 100,000 to 150,000 drawings, sent to Northern Electric in the six-year period between 1959 and 1965. In support of its argument, the taxpayer relied on *English Electric Co. Ltd. v. Musker*<sup>4</sup> to the effect that there is no property right in knowhow. However, counsel for the minister pointed out that Lord Denning in the same case had said that “know-how is an intangible asset, just as intangible as goodwill and just as worthy of recognition,”<sup>5</sup> and therefore argued that the technical information provided to Northern Electric for its limited use was highly valuable proprietary information, and there was “no realistic distinction between this information and any other secret process or trade secret that may be licensed on a similar basis.”<sup>6</sup>

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2 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

3 Convention Between Canada and the United States of America for the Avoidance of Double Taxation and the Establishment of Rules of Reciprocal Administrative Assistance in the Case of Income Taxes, signed at Washington, DC on March 4, 1942, as amended by the protocols signed on June 12, 1950, August 8, 1956, and October 25, 1966 (herein referred to as “the 1942 treaty”).

4 1965 TR 129 (UK HL).

5 Quoted in *Western Electric*, supra note 1, at 5209.

6 Ibid.

Dumoulin J found that the fees paid were a royalty for confidential information that, if not “secret processes,” was of precisely the same nature; accordingly, the fees were subject to Canadian withholding tax.<sup>7</sup>

### **Hunter Douglas Ltd. v. The Queen**<sup>8</sup>

In 1965, the Act was amended to provide that a corporation is deemed to be resident in Canada throughout a taxation year if (1) it was incorporated in Canada after April 26, 1965, or (2) it was incorporated in Canada before April 27, 1965 and, at any time in a taxation year ending on or after April 26, 1965, it either carried on business in Canada or was resident in Canada.

In 1957, Canada and the Netherlands entered into a tax treaty.<sup>9</sup> Article II(1)(f) of the 1957 treaty provided:

The terms “resident of the Netherlands” and “resident of Canada” mean respectively any person who is resident in the Netherlands for the purposes of Netherlands tax and not resident in Canada for the purposes of Canadian tax and any person who is resident in Canada for the purposes of Canadian tax, and not resident in the Netherlands for the purposes of Netherlands tax; a company shall be regarded as resident in the Netherlands if its business is managed and controlled in the Netherlands and as resident of Canada if its business is managed and controlled in Canada.<sup>10</sup>

The Canada-Netherlands Income Tax Agreement Act, 1957,<sup>11</sup> which implemented the 1957 treaty in Canada, provided that in the event of any inconsistency between the provisions of the 1957 treaty and any other law, the provisions of the 1957 treaty shall prevail to the extent of the inconsistency.<sup>12</sup>

Hunter Douglas Limited (“Hunter Douglas”) was “incorporated” in Quebec in 1963 pursuant to an amalgamation of two predecessor corporations. It carried on business in Canada and through 70 subsidiaries elsewhere throughout the world

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7 The commentary on the OECD model convention now provides a detailed discussion of the difference between payments for services and royalties. See paragraphs 11.1 to 11.6 of the commentary on article 12 of the Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf).

8 79 DTC 5340 (FCTD).

9 Convention Between Canada and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Ottawa on April 21, 1957 (herein referred to as “the 1957 treaty”).

10 Article II(1)(f) of the 1957 treaty is identical to the formulation of the residence definition article in the 1946 Canada-UK Tax Convention, SC 1946, c. 38. For an interesting discussion of the history and interpretation of this provision from a UK perspective, see John F. Avery Jones, “The Definition of Company Residence in Early UK Tax Treaties” [2008] no. 5 *British Tax Review* 556-86.

11 SC 1956-57, c. 16.

12 This, of course, is standard wording for Canadian tax treaty implementing statutes.

from which it earned management fees. In 1970, Hunter Douglas moved its central management and control from Canada to the Netherlands to be closer to its European business operations. In conjunction therewith, it sold its Canadian business to a Canadian subsidiary and in 1971 transferred its business and remaining assets to Hunter Douglas NV, a Netherlands Antilles subsidiary.<sup>13</sup> The reasons for judgment of Grant J contain the following puzzling statement:

The plaintiff's earned surplus existing at the time of this change was not distributed but was transferred to the new company, Hunter Douglas, N.V. as it needed those funds in its business.<sup>14</sup>

As consideration for the transfer of the business and assets to Hunter Douglas NV, Hunter Douglas received deferred and common shares of Hunter Douglas NV. In the course of liquidation, in November 1971 it distributed as a dividend to its common shareholders the common shares of Hunter Douglas NV, and in December 1971 it distributed the deferred shares of Hunter Douglas NV to its deferred shareholders. A Dutch ruling was obtained that there would be no immediate Dutch capital gains tax or withholding tax in respect of the payment of such dividends.

Hunter Douglas was assessed Canadian withholding tax on the dividends that it paid to its shareholders who were not resident either in Canada or in the Netherlands.

The Crown admitted that Hunter Douglas was a resident of the Netherlands for the purposes of the 1957 treaty. However, the basis for the assessment was that the 1957 treaty applied only to shareholders of Hunter Douglas who were resident in Canada or the Netherlands and had no application to shareholders who resided elsewhere.<sup>15</sup> The minister appears to have argued that under the Act Hunter Douglas was deemed to be resident in Canada in respect of such shareholders and therefore the dividends paid to them were subject to Canadian withholding tax.

Article IV(5) of the 1957 treaty provided:

Where a company which is resident in one of the States [the Netherlands] derives profits or income from sources in the other State [Canada], [Canada] shall not impose any form of taxation on dividends paid by the company to persons not resident in [Canada], or any tax in the nature of an undistributed profits tax on undistributed profits of the company, by reason of the fact that those dividends or undistributed profits represent, in whole or in part, profits or income so derived.

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13 Although the facts are not entirely clear on this point, Hunter Douglas NV probably acquired the Canadian subsidiary in this transaction.

14 *Supra* note 8, at 5341. As was clarified later in the reasons for judgment, this probably meant that the remaining cash and business assets not transferred to the Canadian subsidiary were transferred to Hunter Douglas NV. A transfer of assets by a company for shares in a subsidiary would not transfer its earned surplus.

15 Article 1 of the various OECD model conventions since 1963 has consistently stated, "This Convention shall apply to persons who are residents of one or both of the Contracting States." Canada's modern treaty practice is to include a similar article in its treaties. However, no such article was included in the 1957 treaty, making the Crown's argument difficult.

The court held that the phrase “by reason of the fact” was to be read as “even if.”<sup>16</sup>

The court held that this meant that where a company was resident in the Netherlands for the purposes of the 1957 treaty, Canada was enjoined by article IV(5) of the 1957 treaty from imposing tax on dividends or undistributed profits paid to residents of countries that were not parties to the 1957 treaty, since article IV(5) “does not differentiate between payments to resident[s] of third countries not parties to the convention and those made to residents of Canada or the Netherlands.”<sup>17</sup>

It was therefore held that the wording in article IV(5) of the 1957 treaty—“that other State shall not impose any form of taxation on dividends paid by the company to persons *not resident in that other State* [emphasis added]”—makes it clear that shareholders of Hunter Douglas that were not resident in either Canada or the Netherlands were entitled to the benefit of such provision, and that the purpose of the provision was to ensure that the dividends paid by a company resident in one state (the Netherlands) would not be taxed by the other state (Canada) except as provided by article VII when they were received by a resident of the state (Canada) seeking to impose such tax.

The court heard testimony from a Dutch tax expert that although a company incorporated under Dutch law is deemed to be resident in the Netherlands for Dutch dividend withholding tax purposes, this is overridden where such a company is resident in another country within the meaning of a tax treaty between the Netherlands and that other country that has a provision similar to article IV(5) of the 1957 treaty. In the reverse scenario of a company incorporated in the Netherlands and deemed to be a Netherlands resident under its internal law that is managed and controlled in Canada, the Netherlands would not impose Dutch withholding tax on dividends paid by the company to shareholders not resident in the Netherlands.

The Dutch tax expert testified that this opinion had been confirmed by the Dutch secretary of state for finance.

In the reasons for judgment, Grant J referred to *Canadian Pacific Ltd. v. The Queen*,<sup>18</sup> in which Walsh J stated that the court has the right to interpret the tax treaty itself and is in no way bound by the interpretation of the other contracting state’s revenue authorities. However, Walsh J also stated that “the result would be unfortunate if it were interpreted differently in the two countries when this would lead to double taxation,” and unless it can be concluded that the interpretation given in the country “was manifestly erroneous it is not desirable to reach a different conclusion.”<sup>19</sup>

16 Supra note 8, at 5345. Article IV(5) of the 1957 treaty is similar to article 10(5) of the OECD model convention, which uses the phrase “even if” in place of “by reason of the fact.”

17 Supra note 8, at 5344.

18 76 DTC 6120 (FCTD); rev’d. in part on other issues, 77 DTC 5383 (FCA).

19 *Canadian Pacific*, supra note 18 (FCTD), at 6135. In a subsequent 1992 Dutch residence case involving the Netherlands-Ireland treaty (Convention Between the Kingdom of the Netherlands and Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at The Hague on February 11, 1969), Dutch

On the wording of the 1957 treaty, and the evidence given, Grant J found that the amendments to the Act respecting the residence of a company were inconsistent with the provisions of the 1957 treaty, and pursuant to the Canada-Netherlands Income Tax Agreement Act, 1957, these amendments could not override article IV(5) of the 1957 treaty. Accordingly, the minister of national revenue had no authority to assess Hunter Douglas for withholding tax on the dividends paid by it to shareholders not resident in Canada.

The *Hunter Douglas* case is noteworthy not only for the fact that expert testimony led by counsel for the taxpayer as to the meaning of the disputed treaty provision was confirmed by a statement of the Dutch tax authority of the Netherlands' interpretation of the treaty, but also for the fact that the court relied on article 31(1) of the Vienna Convention on the Law of Treaties<sup>20</sup> as being applicable to the interpretation of the tax treaty in question. *Hunter Douglas* may be the first tax treaty case in which the Vienna convention was cited.<sup>21</sup> This was eight years before the OECD's first written reference to the principles codified in the Vienna convention. That reference occurred in 1987; in the OECD Committee on Fiscal Affairs report "Double Taxation

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Advocate General Verburg referred to the secretary of state's confirmation letter referred to in *Hunter Douglas* in his opinion to the Hoge Raad, the highest court of the Netherlands. Advocate General Verburg stated that it cannot be inferred that the Netherlands would in all cases refrain from imposing a dividend withholding tax where a company incorporated in the Netherlands is resident for treaty purposes in a treaty partner state and the treaty contains a provision similar to article IV(5) of the 1957 treaty. Also significant, according to Advocate General Verburg, is the fact that the state secretary for finance is presently of a different opinion. See Hoge Raad, September 2, 1992, BNB 1992/379.

- 20 Adopted at Vienna on May 22, 1969 and opened for signature on May 23, 1969 by the United Nations Conference on the Law of Treaties (UN Doc. A/Conf. 39/27, fourth annex, UNTS 1155/331) (herein referred to as "the Vienna convention").
- 21 The Vienna convention did not come into force until January 1980, several months after the decision in *Hunter Douglas* was handed down, and on its terms it applies only to treaties that come into force after that date. However, many later cases and commentary have clarified that, because the Vienna convention largely represents a codification of international law principles, the rules for the interpretation of treaties set out in articles 31 to 33 correctly state the principles to be applied to earlier treaties. See, for example, *Gladden Estate v. The Queen*, 85 DTC 5188 (FCTD); *Cudd Pressure Control Inc. v. The Queen*, 98 DTC 6630 (FCA); United States, Treasury Department, Technical Explanation of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, 2001; *Fothergill v. Monarch Airlines*, [1981] AC 251 (HL); *FC of T v. Lamesa Holdings BV*, 97 ATC 4752 (Full FC); Corte di Cassazione, July 21, 1995, no. 7950 (in *Giurisprudenza Italiana* 1997, I, 697); Cass., Pas., 1977, I, 574 (Belgium); BFH (Federal Tax Court) decision of October 9, 1985, BFHE 145, 341 at 347 (Germany); *Gabcikovo-Nagymaros Project (Hungary v. Slovakia)*, [1997] ICJ Rep. 7, at 42-46 and 99; *Namibia*, [1971] ICJ Rep. 47; *Appeal Relating to the Jurisdiction of the ICAO Council (India v. Pakistan)*, [1972] ICJ Rep. 67; *Fisheries Jurisdiction (United Kingdom v. Iceland)*, [1974] ICJ Rep. 3, at paragraph 36; and *Kasikili/Sedudu Island (Botswana/Namibia)*, [1999] ICJ Rep. 1059, at paragraph 18.

Conventions and the Use of Conduit Companies,”<sup>22</sup> the committee stated: “Where no [safeguards against the improper use of treaty provisions] exist, treaty benefits will have to be granted under the principle of ‘*pacta sunt servanda*’ even if considered to be improper.” This statement appears to come from article 26 of the Vienna convention.<sup>23</sup> In the 1989 OECD publication “Tax Treaty Override,”<sup>24</sup> article 31 of the Vienna convention was expressly referred to. In referring to the Vienna convention in 1979, the Canadian court in *Hunter Douglas* seems therefore to have been ahead of the OECD in explicitly adopting the international law principles codified in the Vienna convention and applying those principles to the interpretation of tax treaties.

## BOWMAN AS JUDGE

After a long and successful career as counsel, Donald Bowman was appointed judge of the Tax Court of Canada in 1991. He became associate chief judge in 2000, associate chief justice in 2003, and chief justice in 2005, a position that he held until his retirement in July 2008. Below, in chronological order, we discuss his most notable cases dealing with tax treaties.

### Merritt v. The Queen<sup>25</sup>

*Merritt* was Bowman J’s first reported tax decision. In this case, Bowman J, interpreted article 17 of the Canada-UK tax treaty.<sup>26</sup> The taxpayer represented himself.

Merritt was a Canadian resident who had received a pension in 1990 from his previous employer, the UK Civil Service. The UK pension plan provided for periodic payments commencing in 1990 and a lump-sum payment in the same year of the equivalent of \$43,000, both of which were free of UK tax. Merritt included the periodic payments and the lump sum in his income in his 1990 Canadian tax return. However, he argued that in computing his income for his 1990 taxation year, he could deduct the amount of the lump sum pursuant to subparagraph 110(1)(f)(i) of the Act as an amount exempt from Canadian tax by reason of article 17 of the Canada-UK treaty. The minister did not agree.

22 OECD, “Double Taxation Conventions and the Use of Conduit Companies,” adopted by the OECD Council on November 27, 1986: see the OECD model convention, supra note 7, vol. 2, R(6)-1 to R(6)-25, paragraph 43.

23 The article, which is titled “*Pacta sunt servanda*,” reads, “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.”

24 Adopted by the OECD Council on October 2, 1989: see the OECD model convention, supra note 7, vol. 2, R(8)-1 to R(8)-11.

25 93 DTC 978 (TCC).

26 Convention Between Canada and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, signed at London on September 8, 1978, as amended by the protocols signed on April 15, 1980 and October 16, 1985 (herein referred to as “the Canada-UK tax treaty”).

Article 17 had been amended in 1985 by the second protocol to the Canada-UK treaty. As amended, article 17(3) defined the term “pension” to include any payment under a superannuation, pension, or retirement plan without distinguishing between periodic and lump-sum payments. By way of contrast, the prior version of article 17(1) in the first protocol to the treaty had explicitly excluded lump sums from the definition of “pensions.” Merritt argued that the definition of “pension” in the second protocol was not intended to change the definition of “pension” in the first protocol; consequently, lump sums should still be excluded from the definition of “pension” for the purposes of the treaty and accordingly should be taxable only in the United Kingdom and not in Canada pursuant to article 17(1) of the treaty.

Bowman J did not accept this argument. He was properly guided by the terms of the treaty, as amended, and stated that he could not “without distorting the meaning of section 3 of the present article 17, attribute to it a meaning derived from the predecessor section.”<sup>27</sup> Though he ultimately found against the taxpayer, Bowman J praised Merritt’s “great skill and thoroughness.”<sup>28</sup>

### **RMM Canadian Enterprises Inc. et al. v. The Queen**<sup>29</sup>

In *RMM Canadian*, heard together with *Equilease Corporation v. The Queen*, Bowman J considered the treatment of a US-resident corporation, Equilease Corporation, that had structured a transaction as a sale of shares of its Canadian subsidiary, Equilease Limited, as an alternative to liquidation of the subsidiary, in order to avoid the section 84 deemed dividend rules. Equilease Limited essentially owned, directly and through a subsidiary, only cash and near-cash assets and had no liabilities. The US parent corporation had decided to wind up the Canadian subsidiary but wanted to avoid withholding tax on what would have been a large section 84 deemed dividend. Accordingly, instead of liquidating Equilease Limited, the US parent chose to dispose of the subsidiary by means of a share sale and to claim exemption from tax on the capital gain under article XIII of the 1980 Canada-US treaty.<sup>30</sup> The disposition was accomplished by incorporating a new Canadian corporation, RMM Canadian Enterprises Inc. (“RMM”), to purchase the shares of Equilease Limited at a price equal to the amount of the aggregate of the subsidiary’s cash and near-cash minus

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27 Supra note 25, at 979. At the time, the Canada-UK tax treaty did not have an other income article of the type included in article 21 of the OECD model convention or the UN model convention (United Nations Model Double Taxation Convention Between Developed and Developing Countries, UN publication no. ST/ESA/PAD/Ser./E/21).

28 Supra note 25, at 979.

29 97 DTC 302 (TCC).

30 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, and March 17, 1995 (herein referred to as “the 1980 treaty”).

\$10,000. The transaction closed in June 1989 and, upon its completion, RMM immediately began winding up the purchased corporation.<sup>31</sup> The entire transaction was financed by a bank loan, which was quickly paid off with the assets of Equilease Limited and its Canadian subsidiary.

RMM and Equilease Corporation were both assessed for part XIII tax on a deemed dividend at the treaty rate of 10 percent.

Bowman J ultimately held for the minister by finding that section 84 and subsection 212(2), or alternatively the anti-avoidance rule in section 212.1, applied to characterize the sale proceeds minus the paid-up capital of the shares of the Canadian company as dividends. However, the decision is notable for his dicta regarding the application of the general anti-avoidance rule (GAAR) in section 245 to the facts of the case. Those dicta are often cited and were perhaps ahead of their time.

Applying a liberal purposive approach to treaty interpretation, Bowman J took the position that GAAR could function to recharacterize the proceeds as dividends for the purposes of the Act; moreover, by applying the definition of the term “dividends” in paragraph 3 of article X (Dividends) of the 1980 treaty and section 3 of the Income Tax Conventions Interpretation Act,<sup>32</sup> the amount could also be characterized as a dividend for the purposes of article X of the treaty. In arriving at this conclusion, Bowman J also made reference to paragraph 7 of article XXIX A (Limitation on Benefits) of the 1980 treaty (added by the 1995 protocol, which postdated the transaction), which stated:

7. It is understood that the fact that the preceding provisions of this Article apply only for the purposes of the application of the Convention by the United States shall not be construed as restricting in any manner the right of a Contracting State to deny benefits under the Convention where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of the Convention.

Citing the US technical explanation<sup>33</sup> of article XXIX A(7), Bowman J concluded that it had always been the intention of the treaty parties to reserve their ability to apply domestic anti-abuse rules to cases arising under the treaty. Further, he said that failing to apply GAAR in the appropriate factual circumstances and thus permitting transactions that would domestically fall offside section 245 to be sheltered under treaty provisions “would be to sanction an abuse of the treaty.”<sup>34</sup> Although Bowman J seemed to agree with the Canada Revenue Agency (CRA) and the Department of Finance that GAAR had always applied to tax treaties, GAAR provisions were

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31 Immediately after the winding up of the purchased corporation into RMM, the purchased corporation's Canadian subsidiary amalgamated with RMM.

32 RSC 1985, c. I-4.

33 United States, Treasury Department, Technical Explanation of the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, April 26, 1984 (herein referred to as “the technical explanation”).

34 *Supra* note 29, at 314.

amended in 2005 (retroactive to 1988) to specifically apply to treaties.<sup>35</sup> The resulting amendment now makes explicit what Bowman J much earlier saw as implicit within the prior wording of section 245.<sup>36</sup>

### **Hausmann Estate v. The Queen**<sup>37</sup>

Bowman J again had the opportunity to interpret treaty provisions—this time the pension provisions of the Canada-Belgium treaty<sup>38</sup>—in *Hausmann Estate*, a case decided under the Tax Court of Canada Rules (Informal Procedure).<sup>39</sup> The late Mr. Hausmann, a Canadian resident, had received pension payments over three years from l'Office National des Pensions under a Belgian statutory pension plan. These payments, ranging in annual amounts between the equivalent of Cdn \$4,700 and Cdn \$5,300, were not taxed in Belgium. Article XVIII(2) of the Canada-Belgium treaty reserved to the source state the exclusive right to tax “social security pensions.” The CRA had been advised by its counterpart at the Belgian Ministry of Finance that Belgium had not taxed these amounts because it does not tax income below a certain threshold. The Belgian officials gratuitously wrote that “when a pension has not actually been taxed in Belgium, Canada can tax the pension without restriction.”<sup>40</sup> In light of this statement, Hausmann was taxed by the CRA on his Belgian pension amounts. In the Tax Court, Bowman J characterized the underlying theory in this way:

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35 On the application of GAAR to tax treaties prior to the 2005 amendment, see the discussion by Jean-Marc Déry and David A. Ward, “Canada,” in *Interpretation of Double Taxation Conventions*, Cahiers de droit fiscal international, vol. 78a (Deventer, the Netherlands: Kluwer Law and Taxation, 1993), 259-93, at 288.

36 For a discussion of the abuse-of-rights principle in international law and its application to tax treaties, see David A. Ward, “Abuse of Tax Treaties,” in Herbert H. Alpert and Kees von Raad, eds., *Essays on International Taxation in Honor of Sidney I. Roberts*, Series on International Taxation no. 15 (Deventer, the Netherlands: Kluwer Law and Taxation, 1993), 397-409; Stef van Weeghel, *The Improper Use of Tax Treaties with Particular Reference to the Netherlands and the United States*, Series on International Taxation no. 19 (La Haye: Kluwer Law International, 1998); and F.A. Engelen, *On Values and Norms: The Principle of Good Faith in the Law of Treaties and the Law of Tax Treaties in Particular* (Deventer, the Netherlands: Kluwer, 2006). For recent cases applying the abuse-of-rights principle to tax treaties, see *A Holdings ApS v. Federal Tax Administration* (2005), 8 ITLR 536 (Switzerland, FC); *Ministre de l'Économie v. Bank of Scotland* (2006), 9 ITLR 683 (France, Conseil d'État); and *Yanko-Weiss Holdings (1996) Ltd. v. Holon Assessing Office* (2007), 10 ITLR 524 (Israel, Dist. Ct. of Tel Aviv). In *MIL (Investments) SA v. The Queen*, 2006 DTC 3307 (TCC); aff'd. 2007 DTC 5437 (FCA), the courts in Canada did not apply the principle of abuse of rights to a tax treaty. The issue of tax treaty abuse has been of concern to the OECD for more than 20 years and was most recently addressed at the OECD Conference on the Fight Against International Tax Evasion and Avoidance, Paris, October 21, 2008.

37 [1998] 4 CTC 2232 (TCC).

38 Convention Between Canada and Belgium for the Avoidance of Double Taxation and the Settlement of Other Matters with Respect to Taxes on Income, signed at Ottawa on May 29, 1975 (herein referred to as “the Canada-Belgium treaty”).

39 SOR/90-688b, as amended.

40 Quoted in *Hausmann*, supra note 37, at paragraph 13.

The theory appears to be that if Belgium is not going to tax the pension Canada should. Otherwise the unthinkable might occur and the amount might not be taxed by anyone. This would be anathema. This view seems to be consistent with the view expressed in the Belgian letter.<sup>41</sup>

As this statement portends, Bowman J ultimately found in favour of the taxpayer. Notably, he examined the Belgium national report in the International Fiscal Association's 1984 Cahiers de droit fiscal international.<sup>42</sup> The Belgian national reporter, Christian Willems, traced the development of the Belgian pension system after the Second World War and highlighted Belgium's efforts to avoid double taxation of these amounts internationally. Bowman J also examined the practice of Canada and the United States under the 1995 protocol amending the 1980 treaty and found that Canada itself interprets language similar to that in the Canada-Belgium treaty to apply to Canada Pension Plan (CPP) payments as "social security benefits." On the basis of both Willems's report and Canada's characterization of CPP payments under the 1980 treaty, Bowman J categorized the Belgian pension plan as a "social security pension" and therefore exempt from tax in Canada and exclusively taxable in Belgium pursuant to article XVIII(2) of the Canada-Belgium treaty.

Bowman J's decision in *Hausmann* is an early finding that a taxpayer may have the benefit of a double taxation provision in a tax treaty even if it leads to what has been somewhat inelegantly described as "double non-taxation." A similar finding had already been made by Addy J of the Federal Court Trial Division in *Gladden Estate*,<sup>43</sup> a case involving a capital gain on the deemed disposition of taxable Canadian property owned by a deceased US-resident individual. Addy J found the capital gain not to be subject to Canadian tax under the 1942 Canada-US treaty notwithstanding that the gain was not subject to US tax. He stated that

on a simple reading of Article VIII, it seems evident that double taxation is neither a condition nor a prerequisite for invoking the protection of the treaty. The non-resident can benefit from the exemption regardless of whether or not he is taxable on that capital gain in his own country.<sup>44</sup>

The point has arisen in other cases since *Gladden Estate* and *Hausmann*. For example, in *Union of India v. Azadi Bachao Andolan*,<sup>45</sup> the Supreme Court of India cited

41 Ibid., at paragraph 15.

42 Christian Willems, "Belgium," in *Social Security Contributions as a Fiscal Burden on Enterprises Engaged in International Activities*, Cahiers de droit fiscal international, vol. 69b (Deventer, the Netherlands: Kluwer Law and Taxation, 1984), 227-45.

43 *Gladden Estate*, supra note 21.

44 Ibid., at 5192.

45 (2003) 6 ITLR 233 (India, SC (Civ. App. Div.)) (a Mauritian-resident company was exempt from capital gains tax on the disposition of Indian property by virtue of a provision in the Agreement Between Mauritius and India for the Promotion and Protection of Investments, signed at Mauritius on September 4, 1998).

Bowman J's holding in *Hausmann* for the same proposition that a taxpayer may have the benefit of a treaty even if it leads to "double non-taxation." Likewise, in *MIL (Investments) SA v. The Queen*,<sup>46</sup> Bell J made a similar finding in relation to the Canada-Luxembourg treaty.<sup>47</sup> Perhaps the only basis on which to support the view of the Belgian tax officials in *Hausmann* would be to permit "object and purpose" referred to in article 31(1) of the Vienna convention to override the clear ordinary meaning of the terms of the treaty, an interpretive technique that is not supported by article 31 as explained in the International Law Commission's commentary on the penultimate draft of article 31.<sup>48</sup>

### **Sumner et al. v. The Queen**<sup>49</sup>

In *Sumner*, Bowman J heard two appeals jointly involving the 1980 treaty. Sumner, a popular rock star known as Sting, included six Canadian concerts in an extensive 1991 North American tour.<sup>50</sup> Sumner's services were provided through a loanout arrangement with Roxanne Music Inc. ("Roxanne"), a US-resident corporation with no permanent establishment in Canada.<sup>51</sup> Roxanne had agreed to pay a salary equaling 95 percent of the North American tour's net profit, which salary amounted to US\$1,488,000. In Sumner's appeal, the issue was the proper calculation of the Canadian portion of his salary that was subject to Canadian tax. Sumner had used a time method of allocation, which involved multiplying his total salary by 6/240, where 6 was the number of days that he worked in Canada and 240 was the total number of days that, he alleged, he worked for Roxanne.<sup>52</sup> The minister assessed Sumner's salary using a gross receipts method of allocation, which involved apportioning his total

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46 *MIL (Investments)*, supra note 36.

47 Convention Between Canada and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Luxembourg on September 10, 1999.

48 United Nations, International Law Commission, "Draft Articles on the Law of Treaties with Commentaries, Adopted by the International Law Commission at Its Eighteenth Session," in David A. Ward et al., *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model* (Kingston, ON: International Fiscal Association, Canadian Branch, 2005), appendix IV, 240-49.

49 2000 DTC 1667 (TCC).

50 The duration of the North American tour is unclear in the case. Sumner claimed that his tour was 240 days (eight months), but Bowman J found that this period included an unspecified number of days that had nothing to do with the tour.

51 All of the shares of Roxanne were owned by a Dutch company, all of the shares of which were owned by an individual unrelated to Sumner. While Sumner argued that he and Roxanne were dealing at arm's length, Bowman J found that the appeals did not turn on that issue.

52 With a Canada-US exchange rate of 1.15, Sumner calculated his taxable Canadian salary at 6/240 of US\$1,488,000 or Cdn\$42,780.

salary by the proportion of revenue from Canadian concerts to the total revenue.<sup>53</sup> Bowman J decided against Sumner and held in this case that the time method of allocating income had not been established to be more reasonable than the gross receipts method used by the minister.

Roxanne also appealed its assessment. Although the amount at issue is not clear, the appeal presumably related only to the 5 percent of the tour's net profits that were not paid to Sumner.<sup>54</sup> Roxanne argued that it was not taxable in Canada because it did not have a Canadian permanent establishment and so was exempt under paragraph 1 of article VII (Business Profits) of the treaty. The minister conceded that Roxanne had no permanent establishment in Canada, but relied on article XVI (Artistes and Athletes), which reads in part as follows:

1. [I]ncome derived by a resident of a Contracting State as an entertainer, . . . or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State [subject to an exemption if less than \$15,000].

2. Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete but to another person, that income may, notwithstanding the provisions of Articles VII (Business Profits), and XV (Income from Employment), be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised. For the purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, . . . or other distributions.<sup>55</sup>

53 The Canadian concerts had revenue of US\$543,494 and the North American tour had total revenue of US\$5,965,599. As a result, 9.11 percent of the salary was earned in Canada. With a Canada-US exchange rate of 1.15, the minister's allocation led to Sumner's having taxable Canadian income of \$155,890.

54 The amount at issue in Roxanne's appeal was not stated in the reasons for judgment. Accepting that 95 percent of Roxanne's profits (before the deduction of Sumner's salary) was US\$1,488,000, the remaining 5 percent (being the net profits after deduction of the salary) would be US\$78,316. Using the gross receipts method of allocation, 9.11 percent of this (US\$7,135 or Cdn\$8,205) would have been earned in Canada.

55 The second sentence of paragraph 2 is somewhat ambiguous and is not in the OECD model convention. A similar provision does, however, appear in article 17(2) of the 1981 US model income tax treaty (United States, Treasury Department, Model Income Tax Treaty of June 16, 1981, which was the most current at the time the case was heard), and also in the 1996 US model (United States, Treasury Department, United States Model Income Tax Convention of September 20, 1996), but not the 2006 US model (United States, Treasury Department, United States Model Income Tax Convention of November 15, 2006). The second sentence of paragraph 2, article XVI of the 1980 treaty is also explained in the US technical explanation to the treaty in a way that is consistent with the interpretation given to article 17(2) by Bowman J (discussed below). Very few of Canada's tax treaties contain similar wording; the other treaties that do are those with India, Korea (Rep.), and Venezuela. Accordingly, Bowman J's reasoning in Roxanne's appeal should be restricted to those treaties that include wording similar to

Roxanne argued that paragraphs 1 and 2 of article XVI were mutually exclusive and that paragraph 2 could not be applied if the performer was taxable on all of his income earned in Canada under paragraph 1. Sumner did not attempt to escape paragraph 1 because he had included what he claimed was the correct portion of his salary from Roxanne as taxable income in Canada. Roxanne also argued that Sumner was not participating “directly or indirectly in the profits” of Roxanne within the meaning of paragraph 2.

Bowman J rejected Roxanne’s arguments and found in favour of the minister. He found that Sumner was in fact participating in Roxanne’s profits because his 95 percent share amounted to “bonuses . . . or other distributions.” Bowman J also found that paragraphs 1 and 2 were not mutually exclusive, basing his conclusion in part on the technical explanation and paragraph 11 of the commentary on article 17(2) of the OECD model convention (which was added in 1992, after the tour had been completed).<sup>56</sup> The introduction to the commentary on article 17(2) states that “the portion of the income which cannot be taxed in the hands of the performer may be taxed in the hands of the person receiving the remuneration.”<sup>57</sup> Bowman J found that the use of the word “portion” meant that the 1980 treaty envisioned that paragraphs 1 and 2 of article XVI operate together.<sup>58</sup>

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article 17(2) of the US model treaty, and may not apply to treaties based on the language of the OECD model convention, since article 17(2) of the OECD model applies only when “income from the personal activities exercised” by the entertainer or athlete accrues to another person. If the entertainer or athlete is fully paid, article 17(2) arguably is inapplicable. Read in light of the United States’ and Canada’s reservations on article 17 of the OECD model, a tax treaty with article 17(2) of the OECD model could have been interpreted to support Roxanne’s argument, since Sumner seems to have had no right to any part of the 5 percent of the profits retained by Roxanne. The technical explanation supported Bowman J’s decision because it provided that if the company makes payments to the entertainer based on profits of the company, all the profits of the company attributable to the performer’s US activities may be taxed by the United States. Bowman J gave this explanation reciprocal effect. Klaus Vogel, however, seems to have had the view of the OECD model provision, which may have been derived from changes in the commentary made in 1995 and 2000 that reversed the interpretation given in prior commentary, that article 17(2) of the model could be applied to tax the profits of the event organizer. See Klaus Vogel et al., *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation on Income and Capital*, 3d ed. (The Hague, Kluwer Law International, 1997), article 17, paragraph 42.

56 Although the 1992 commentary postdated the 1980 Canada-US treaty, that fact was not mentioned in the reasons for judgment. This issue has been dealt with in Ward et al., supra note 48, at 95-96.

57 Paragraph 11 of the OECD commentary on article 17 (OECD model tax convention, supra note 7).

58 Bowman J did not refer to the 1992 reservations made by Canada and the United States that article 17(2) of the OECD model should be applied only to avoidance schemes. While it is unclear in the reasons for judgment whether or not Bowman J viewed Sumner’s arrangement with Roxanne as an avoidance scheme, because Sumner admitted taxability and Roxanne retained only 5 percent of the tour’s profits, the case could be made that, on the facts as reported, the arrangement was bona fide.

**Watts v. The Queen**<sup>59</sup>

*Watts* was an informal procedure case decided by Bowman J (as associate chief justice), in which the taxpayer represented himself. Watts was a US resident who had worked in Canada; he had become seriously ill and received benefits under his Canadian workplace disability insurance scheme, as well as disability payments under the CPP. He included both the workplace disability and the CPP payments in his income from employment under paragraph 6(1)(f) of the Act. He also claimed a number of non-refundable credits, such as the basic personal amount and spousal and medical expense credits. While this is not stated in the judgment, Watts probably characterized the payments he received as Canadian employment income in order to access these credits and thus offset tax on his disability payment income. The minister took the position that while the workplace disability payments constituted Canadian employment income, the CPP payments were a social security pension exclusively taxable in the United States; accordingly, Watts could not claim the credits that he did because when the CPP payments were excluded, less than 90 percent of his income was included in his taxable income earned in Canada. Bowman J upheld the minister's application of article XVIII of the 1980 Canada-US treaty to levy a 15 percent withholding tax on the amounts paid by the Canadian workplace disability insurance scheme and not to tax the CPP amounts because article XVIII(5) states that benefits paid under the social security legislation of either country are taxable only in the country where they are received (in this case, the United States).

The minister denied most of the credits claimed by Watts under section 118.94 of the Act, which states that certain credits cannot be claimed if a non-resident does not include "all or substantially all" of his income in his taxable income earned in Canada. When the CPP payments (which were taxable only in the United States) were excluded, only the remaining 76 to 81 percent of the remaining income (depending on the year in issue) was taxable in Canada, and this represented less than "all or substantially all" of Watt's income. Bowman J, clearly sympathetic to the taxpayer, held that the minister's position that "all or substantially all" meant 90 percent or more was "arbitrary" and that, on the facts of this case, Watts's disability insurance payments were "all or substantially all" of his income.<sup>60</sup> Bowman J allowed Watts's appeal in part, excluding the CPP payments but nonetheless allowing him to claim the various credits.

59 2004 DTC 3111 (TCC).

60 *Ibid.*, at paragraphs 33 and 35. For the interpretation of "substantially all" as elastic and potentially constituting less than 90 percent, Bowman J cited the following decisions: *McDonald v. The Queen*, 98 DTC 2151 (TCC); *Keefe v. The Queen*, 2003 DTC 1526 (TCC); *McKay v. The Queen*, [2000] GSTC 93 (TCC); *Rubl (W.) v. The Queen*, [1998] GSTC 4 (TCC); *Pronovost v. The Queen*, 2003 DTC 720 (TCC); *Lim (J.H.) v. Canada*, [2000] GSTC 1 (TCC); *Palser v. Grinling*, [1948] AC 291 (HL); *AE Terry's Motors Ltd. v. Rinder*, [1948] SASR 167 (Austl. SC); *Tillmanns Butcheries Pty. Ltd. v. Australasian Meat Indust. Employees' Union and Others* (1979), 42 FLR 331 (Austl. Full FC); *Gimbel v. Signal Companies Inc.* (1974), 316 A. 2d 599 (Del. Ch.), cited in *Re Olympia & York and Hiram Walker* (1986), 59 OR (2d) 254 (Div. Ct.); and *Philadelphia Nat. Bank v. BSF Co.* (1964), 41 Del. Ch. 509.

### Merrins v. The Queen<sup>61</sup>

Bowman J (as chief justice) again dealt with pensions in *Merrins* (another informal procedure case), this time under the 1966 Canada-Ireland treaty. As in *Merritt* and *Watts*, in this case the taxpayer represented himself. Merrins was an Irish resident who had received, among other amounts, old age security (OAS) payments from the Canadian government. Under article IX of the 1966 Canada-Ireland treaty,<sup>62</sup> residents of Ireland were exempt from Canadian tax on “pension” amounts. Bowman J found that OAS payments did not fall within the meaning of “pension” in the 1966 Canada-Ireland treaty, which was defined as “periodic payments made in consideration of past services.”<sup>63</sup> He went on to examine and ultimately deny further credits that Merrins had incorrectly claimed.

In both *Watts* and *Merrins*, as well as *Merritt*, Bowman J sympathetically heard taxpayers representing themselves on obviously technical points of law. While ultimately reaching different results for the taxpayers, all three cases serve as a reminder that tax treaties may affect sophisticated businesses and individuals receiving comparatively modest amounts of disability payments and social security support.

### CONCLUSION

In his decisions, Bowman J clearly applied a textual interpretation of the treaties in issue, an important point made clear in the Supreme Court of Canada’s decision in *The Queen v. Crown Forest Industries Limited et al.*<sup>64</sup> and in the International Law Commission’s commentary on the penultimate draft of article 31 of the Vienna convention.<sup>65</sup> Whether as counsel or judge, Bowman often anticipated important developments in treaty interpretation. In *Hunter Douglas*, he led evidence from a Dutch expert on the Netherlands’ application of the Canada-Netherlands treaty. This evidence makes clear his view of the advisability of a consistent interpretation of treaties in both contracting states. In *RMM Canadian*, Bowman J stated (in obiter) that the scope of GAAR was broad enough to capture the abuse of a tax treaty even though, at the time, a specific reference to tax treaties was not included in the GAAR provision. Parliament’s later “clarification” of GAAR arguably confirmed Bowman J’s views. In *Summer*, Bowman J followed the lead of the Supreme Court in *Crown Forest* in considering extrinsic sources such as the OECD commentary (albeit later commentary) and the lead of the Federal Court of Appeal in *AG of Canada v. Kubicek Estate*<sup>66</sup> in considering the US technical explanation to interpret the 1980 treaty. In each of *Merritt*, his first treaty interpretation case, and *Watts* and *Merrins*, his final treaty interpretation cases, Bowman J demonstrated his well-known sympathetic attitude toward taxpayers representing themselves.

61 2005 DTC 1273 (TCC).

62 An Agreement Between Canada and Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Ottawa on November 23, 1966 (herein referred to as “the Canada-Ireland treaty”).

63 Article XI of the Canada-Ireland treaty.

64 95 DTC 5389 (SCC).

65 Supra note 48, at 257-59.

66 97 DTC 5454 (FCA).