Hybrid Foreign Entities, Uncertain Domestic Categories: Treaty Interpretation Beyond Familiar Boundaries

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Horatio: O day and night, but this is wondrous strange!

Hamlet: And therefore as a stranger give it welcome.
There are more things in heaven and earth, Horatio,
Than are dreamt of in your philosophy.

Shakespeare, Hamlet, Act 1, scene 5

PRÉCIS
Les entités créées en application du droit étranger qui ne ressemblent pas étroitement à des entités créées en application du droit interne présentent des défis relativement à l’application des dispositions des conventions fiscales. Certains de ces défis proviennent de l’incertitude quant à la façon d’appliquer des concepts qui relèvent du droit interne et des conventions fiscales à des entités ayant des attributs juridiques qui ne correspondent pas tout à fait aux attributs des entités nationales. Le présent article s’inspire de la philosophie du langage pour jeter un nouvel éclairage sur la démarche qui consiste à appliquer des concepts de droit fiscal interne, comme la société par actions, la société de personnes, la résidence, etc. aux entités hybrides étrangères. Tout en abordant la question de la classification des entités, l’article n’impose pas de méthode particulière de classement des entités étrangères aux fins de l’impôt; il examine plutôt de quelle façon la langue juridique peut permettre aux catégories qui se trouvent dans les conventions fiscales dont le Canada est signataire de s’adapter aux entités étrangères, même lorsque celles-ci affichent des attributs inhabituels.

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L'auteur suggère que certaines idées issues de la philosophie du langage présentent une grande utilité pour savoir comment les dispositions des conventions fiscales peuvent être appliquées de manière cohérente à l’égard des entités hybrides étrangères dans le cadre du régime fiscal de ressort national. Ces conceptions philosophiques expliquent comment appliquer des catégories linguistiques générales à des phénomènes limites ou nouveaux pour y trouver un certain « air de famille » plutôt que d’y chercher des traits essentiels. Elles peuvent aussi s’avérer utiles lorsqu’il s’agit de déterminer si les revenus, les pertes ou les gains réalisés par une entité hybride doivent donner droit aux avantages d’une convention, sans qu’il soit nécessaire à tout coup de classer en premier lieu l’entité grâce à des concepts de droit national comme la société par actions ou la société de personnes. La valeur de ces idées est examinée dans une lecture attentive de trois affaires mettant en cause des entités hybrides : Memec, Swift et TD Securities LLC. De différentes façons, ces affaires subordonnent le rôle de la classification des entités dans l’interprétation des conventions à une analyse téléologique prenant en compte le contexte précis de la convention ainsi que l’objectif d’une répartition juste de la compétence fiscale.

**ABSTRACT**

Entities formed under foreign law that do not closely resemble entities formed under domestic law present challenges to the application of tax treaty provisions. Some of these challenges arise from uncertainty as to how to apply concepts found in domestic tax law and tax treaties to entities having legal characteristics that do not fully correspond to those of domestic entities. This article brings insights from the philosophy of language to bear upon the process of applying domestic tax concepts, such as “company,” “partnership,” “residence,” etc., to foreign hybrid entities. While discussing entity classification, the article does not prescribe any particular method for classifying foreign entities for tax purposes; instead, it considers how legal language can allow the categories found in Canada’s tax treaties to adapt to foreign entities, even when these entities exhibit unusual characteristics.

The author suggests that certain insights from the philosophy of language provide helpful tools for understanding how tax treaty provisions can be applied in coherently addressing foreign hybrid entities within the framework of the domestic jurisdiction’s tax system. These philosophical conceptions explain the application of general linguistic categories to borderline/novel phenomena as a recognition of a “family resemblance” rather than a discovery of essential characteristics. They also can assist in thinking about whether the income, loss, or gain realized by a particular hybrid entity should be entitled to treaty relief, without in all cases first classifying the entity using domestic concepts such as “corporation” or “partnership.” The value of these ideas is explored in a close reading of three cases involving hybrids: Memec, Swift, and TD Securities LLC. To varying degrees, these cases subordinate the role of entity classification in treaty interpretation to a purposive analysis that takes into account the particular treaty context and the objective of achieving a fair allocation of taxing jurisdiction.

**KEYWORDS:** HYBRIDS • FOREIGN • ENTITY • TREATIES • RESIDENCE • INTERPRETATIONS
INTRODUCTION

Entities formed under foreign law that do not closely resemble entities formed under domestic law pose very generally two kinds of challenges to the application of the provisions of a tax treaty. First, there may be uncertainty as to whether the foreign entity or its members should be treated as the person(s) in whose hands a particular item of income is taxable. Second, there may be uncertainty as to how to apply concepts found in domestic tax law and in the relevant treaty to an entity having legal characteristics that are not readily assimilated to those of entities whose tax treatment is well established in the jurisdiction applying the treaty. The two types of uncertainty might be called two sides of the same coin, since difficulties in determining who derives an item of income are often due to the encounter of a necessarily limited fiscal vocabulary with unfamiliar and complex forms of legal relations. However, general terms—even ones like “company,” “partnership,” and “person,” whose meaning may not have been questioned before someone attempted to apply them in unfamiliar contexts—are not static and often have multiple shades of meaning that are capable of transformation and growth. It is the aim of this article to bring to the fore and elucidate this aspect of the language with which we approach foreign entities.

Although touching often on entity classification, this article does not prescribe any particular method for classifying foreign entities for tax purposes; instead, it takes a step back to consider how it is that legal language generally can allow the categories found in Canada’s tax treaties to assimilate and adapt to foreign entities exhibiting often surprising characteristics, and also to consider the reasons why, as part of that encounter, certain domestic-law categories may resist transformation.

More specifically, this article has three parts. The first sets out the manner in which Canadian courts and tax authorities typically approach foreign entities. This section acknowledges the very legitimate reasons why it is often necessary to classify foreign entities on the basis of domestic-law categories. It also notes some of the presuppositions involved in the Canadian approach that may be worth reconsidering.
or at least rendering more explicit, in part because, as noted later in the article, assimilating a hybrid entity to a domestic-law category is not the only way to determine how to apply a treaty provision to income earned by or through a hybrid entity.

The second part of the article introduces certain concepts from a perhaps unexpected quarter—the philosophy of language\(^1\)—that can help to situate and explain entity classification as one example of a more general process of legal interpretation involving the extension of the meaning of general terms to novel situations. The purpose here is to attempt to identify aspects of legal language that may be used to illuminate what occurs when the terms in which a tax treaty is framed encounter a hybrid entity. Particular attention is given to the characteristics of legal language that allow it to assimilate foreign legal constructs within domestic-law categories, a process in which countervailing forces are at play—those that allow for an expansion of such categories and those militating in favour of the preservation of familiar boundaries.

The third part of the article brings those philosophical concepts to bear upon three court cases involving tax treaties and hybrid entities—Memec Plc v. IRC,\(^2\) Swift v. Revenue & Customs,\(^3\) and TD Securities (USA) LLC v. The Queen\(^4\)—in order to deepen our understanding of the cases as well as the richness and limits of our existing tax lexicon.

**THE CONSENSUS VIEW OF CANADIAN TAXPAYERS AND TAX AUTHORITIES: DESCRIBE, ANALOGIZE, CLASSIFY**

The need to classify foreign entities or their distributions may arise in different contexts. For instance, in the outbound context, a person resident in Canada may need to know whether income earned by an entity of which the person is a member is income of the person for foreign tax credit purposes,\(^5\) whether the person may deduct losses of the entity,\(^6\) or whether the foreign entity is a corporation such that

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4. 2010 TCC 186.
5. See, for example, CRA document no. 2006-0203181I7, November 8, 2006, which dealt with the situation where a Canadian-resident member of a Pakistani “association of persons” sought to claim a Canadian foreign tax credit for taxes paid by the association of persons.
6. See, for example, Economics Laboratory (Canada) Limited v. MNR, 70 DTC 1208 (TAB); Rufus Matheson v. MNR, 63 DTC 490 (TAB); and Backman v. Canada, 2001 SCC 10, at paragraph 17: “We are of the view that, where a taxpayer seeks to deduct Canadian partnership losses through
it may be treated as a foreign affiliate. In the inbound context, the most frequently encountered question is whether income, profit, or gain to which Canadian tax potentially applies should be treated as belonging to the entity or to its non-resident members; but other questions also arise—for instance, is a non-resident entity that is carrying on business in Canada a “company,” such that a treaty-reduced rate of branch profits tax may apply? These various types of questions arise in the context of Canadian tax legislation and, if applicable, a particular bilateral tax treaty, and it is rightly considered that such questions must be answered using the language of the statute or the treaty.

Canada’s Income Tax Act can be said to recognize, with varying degrees of explicitness, four categories of business organization: (1) corporations, (2) partnerships, (3) trusts, and (4) a residual category that could be said to include unincorporated associations, co-ownership arrangements, common contractual arrangements, organizations, syndicates, federations, etc. (which will be referred to here as “collective arrangements”). In respect of each of the first three types of business organization, the Act contains a detailed and well-understood regime for taxing the entities and/or members of the entities. In the case of collective arrangements, in general the members of the unincorporated association, co-ownership or contractual arrangement, etc., will be treated as the relevant taxpayers.

s. 96 of the Act, the taxpayer must satisfy the definition of partnership that exists under the relevant provincial or territorial law.”

7 See, for example, CRA document no. 9518095, July 13, 1995, in which the CRA concluded that a New York limited liability company (LLC) was a corporation and a foreign affiliate for the purposes of the Act, notwithstanding that as a result of a provision in the articles of organization, all of the members of the LLC were liable in their capacity as members for all debts, obligations, or liabilities of the company.

8 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.

9 While no such regime exists for the fourth category—only a collection of definitions and rules that provide for specific tax consequences (in somewhat narrow contexts) flowing from the fact that something is or is not an association, organization, etc.—one should not lose sight of the fact that the forms of business organization that Canadian tax law recognizes for purely domestic purposes are not limited to corporations, partnerships, and trusts. See, for example, the following provisions of the Act: subsection 94.1(2), where “non-resident entity” is defined to mean, among other things, “an organization, fund or entity that is not resident or is not situated in Canada”; subsection 95(1), where “entity” is defined as including “an association, a corporation, a fund, a natural person, a joint venture, an organization, a partnership, a syndicate and a trust”; subsection 163.2(1), which provides a definition of “entity” similar to that in subsection 95(1); paragraph 118.04(2)(a), which provides that “a qualifying expenditure of an individual includes an outlay or expense made or incurred by a co-operative housing corporation, a condominium corporation (or, for civil law, a syndicate of co-owners) or a similar entity (in this paragraph referred to as the 'corporation')”; subsection 66(15), paragraph (d) of the definition of “Canadian exploration and development expenses,” which includes “the taxpayer’s share of the Canadian exploration and development expenses incurred after 1971 by any association, partnership or syndicate in a fiscal period thereof, if at the end of that fiscal period the taxpayer was a member or partner thereof”; subsection 137(6), in which “credit union” is
The set of entities explicitly named and recognized in Canada’s tax treaties is more open-ended. Most such treaties apply to “persons” who are residents of one or both of the contracting states. The term “person” is often, but not always, defined as it is in article 3 of the model treaty of the Organisation for Economic Co-operation and Development (OECD), as designating “an individual, a company and any other body of persons.” Similarly, “company” is typically defined as it is in the same article, as meaning “any body corporate or any entity that is treated as a body corporate for tax purposes.” These terms are so broad in scope that in a well-known English decision, it was held that a partnership was a body of persons and thus a “person” capable of being a “resident” for the purposes of the relevant treaty. Moreover, the treatment of partnerships and their members under Canada’s tax treaties is a matter that is largely unaddressed in the text of the treaties themselves, which typically do not lay down specific conditions for when an entity may be treated as fiscally “transparent.” Thus, in terms of a vocabulary for referring to forms of business organization, tax treaties present a much less fixed or closed set of categories than does the Act.

Given that Canadian tax legislation and tax treaties contain a limited, if sometimes not entirely closed or well-defined, set of terms for referring to forms of business organization, and that tax results often depend on the application of rules that utilize these terms, in many circumstances the need arises to decide whether a particular business organization is best called, for example, a “body corporate” or a “partnership” or something else. Generally speaking, a consensus has developed in Canada among tax practitioners and the Canada Revenue Agency (CRA) that foreign entity classification is a two-step process. While there may be differences as
to specific aspects of the approach, the general view is that entity classification for Canadian tax purposes involves

1. identifying the characteristics of a foreign entity under the governing commercial law and relevant organizing documents; and
2. comparing those characteristics with the characteristics of a corporation, partnership, trust, or collective arrangement formed under Canadian commercial law, in order to assign the foreign entity to the domestic category that seems the best match. The two-step approach does not require that a foreign form of business organization may only be classified as a trust, corporation, or partnership, since a possible outcome is classification as a co-ownership or other form of collective arrangement. A few observations about this approach should be noted. First, it is a “one size fits all” approach. By and large, it is not suggested that this methodology for classifying foreign entities is appropriate in some contexts and not in others. Second, this approach operates on the assumption that we already know (or can with some

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13 See, for example, Economics Laboratory, supra note 6, in which the Tax Appeal Board analyzed the legal characteristics of a German Gesellschaft mit beschränkter Haftung (GmbH) under German law and concluded that such an entity (though differing in significant respects) resembled a Canadian limited company, so that a Canadian-resident member of the GmbH was not entitled to claim the entity’s losses for Canadian tax purposes. See also Backman, supra note 6, and Spire Freezers Ltd. v. Canada, 2001 SCC 11. The CRA has expressly adopted the two-step approach. See Income Tax Technical News no. 38, September 22, 2008.

14 See, for example, CRA document no. 2009-0347901R3, 2010, in which the principal issue was “[w]hether a Dutch closed FGR [fonds voor gemene rekening] would be classified as a co-ownership arrangement rather than a corporation, a partnership or a trust,” and the CRA ruled that the FGR was a co-ownership arrangement. See also CRA document no. 2007-0231581R3, 2008, in which the CRA took the position that the attributes of a Luxembourg fonds commun de placement “more closely resemble those of a co-ownership arrangement than those of a trust, corporation or partnership.” A similar conclusion was reached with respect to certain Austrian investment funds in CRA document no. 2005-0114031R3, 2006, and a French fonds commun de placement à risques in CRA document no. 2001-0092025, October 23, 2001. Finally, the CRA has ruled on various occasions that for the purposes of the Act, an Irish common contractual fund is “a non-entity” and that each investor is a co-owner of the assets of the fund: see, for example, CRA document nos. 2004-0067771R3, 2004; 2004-0067771R3, 2004; 2006-0199741R3, 2006; 2009-0341561R3, 2010; and 2010-0333901R3, 2010.
work identify) the common and accepted domestic-law meaning of terms like “partnership,” “trust,” and “corporation,” and that in each case there is more or less a single meaning of the term,\(^{15}\) notwithstanding (1) the significant differences (with respect to trusts and partnerships) between Quebec civil law and the common-law provinces;\(^{16}\) (2) the differences between how certain terms, such as “corporation” and its French counterpart “société,” are defined in the Act;\(^{17}\) and (3) the fact that often there is not a single type of partnership, trust, or corporation existing even within a jurisdiction (for instance, in Canada, consider unlimited liability companies existing under the laws of certain provinces, which are as much “corporations” for the purposes of the Act as companies whose shareholders enjoy limited liability). Finally, the two-step approach does not seem to contemplate that the result of the second step may be inconclusive; that is, it tends to lead us to expect that no matter how different in nature from a Canadian corporation, trust, partnership, or collective arrangement, a foreign entity must in the end be made to fit one of those categories.

The generally accepted manner of classifying foreign entities in Canada can be likened to trying to fit square pegs into round holes,\(^{18}\) an apt description of many of the encounters between, on the one hand, a tax lexicon erected on a foundation of domestic commercial law and, on the other hand, entities created under foreign commercial law. However, there is one sense in which the metaphor can mislead, for it suggests or assumes that the Canadian categories (the round holes) have, like simple geometric figures, determinate and readily discernible boundaries. To what extent we should be calling that assumption into question is the burden of the discussion that follows.

\(^{15}\) The assumption, however, has been called into question. See, for example, Darmo, supra note 12, at 489-93, for a discussion of the difficulty of determining the boundaries of the domestic categories of business association (trust, partnership, and corporation).

\(^{16}\) For example, while a partnership in the common-law provinces must always have at least two members, a partnership formed under the laws of Quebec may temporarily have only one partner. See article 2232 of the Civil Code of Quebec, SQ 1991, c. 64, as amended: “The uniting of all the shares in the hands of a single partner does not entail dissolution of the partnership, provided at least one other partner joins the partnership within 120 days.” More generally, compare the nuances in the different ways that the question of partners’ interests in partnership property is treated in the common-law provinces and in Quebec: see, for example, *Kucor Construction & Developments & Associates v. Canada Life Assurance Co.*, 1998 CanLII 4236 (Ont. CA) (an Ontario limited partnership is not a discrete legal entity capable of holding title to real property) and *Ferme CGR enr., s.e.n.c. (Syndic de)*, 2010 QCCA 719 (a Quebec partnership, while not a separate legal entity, has an autonomous patrimony that is distinct from the patrimony of the partners).

\(^{17}\) See Boidman and Kandev, supra note 12. While that article does not call into question the notion that there is (or should be) a single or at least a core meaning of the term “corporation” for the purposes of the Act, one of its important contributions is to challenge those who thought that they had correctly identified that meaning without taking into account both of Canada’s private-law legal systems and the French-language version of the Act.

\(^{18}\) See Boidman and Kandev, supra note 12, at 887.
THE FUNCTIONS OF GENERAL TERMS
IN CANADIAN TAX LAW GENERALLY

The problems of classification addressed in this article happen to lie at the intersection of different legal systems and involve so-called hybrid entities, but in concept there is nothing exotic about these problems, for they are an everyday component of law generally, including tax law, in both its cross-border and purely domestic guises. Courts are constantly asked to extend the application of a general term to cases that contain only some of the same characteristics of the cases to which the term had hitherto been applied. To select only a very few examples, Canada’s courts have been called upon to decide

- whether the term “exploitation” (of natural resources) includes the shipping of crude oil on an ocean vessel;\(^\text{19}\)
- whether the phrase “incomes . . . from the production . . . [of] metals or minerals” encompasses profits on forward contracts hedging such production;\(^\text{20}\) or
- whether a van and trailer placed on vacant land constitute a “housing unit.”\(^\text{21}\)

(The answer in each case was affirmative.) Each of these is an instance of the application of general terms to novel or borderline cases—precisely the conditions in which foreign entity classification takes place. In order to better understand the latter, it is helpful to consider what judicial reasoning consists of in the simpler domestic cases. In this regard, there are valuable insights to be gained from a domain that may seem far removed from the practical work of the tax lawyer or tax judge.

The philosophy of law and the philosophy of language provide some powerful concepts for thinking about the use of general terms in legal rules, having addressed such questions as how the various instantiations of a general term are related, what it is about language that allows general terms to adapt to novel phenomena, and what is the role of judicial discretion in the application of general terms to borderline cases. Immediately below are summarized key insights on these issues of two thinkers, Ludwig Wittgenstein and H.L.A. Hart,\(^\text{22}\) with a view to an improved

\(^{19}\) Dunbar v. The Queen, 2005 TCC 769. In this case, the applicable statutory test, in subsection 122.3(1) of the Act, was whether the taxpayer was engaged in the “exploitation of petroleum, natural gas, minerals or other similar resources.” The Canadian government argued that the taxpayer, a crude oil shipper, was not engaged in the exploitation of petroleum since, in the government’s view, exploitation was at an end when the crude oil was sold by the producer to the producer’s customer (to whom the taxpayer was delivering the oil in a supertanker). The court rejected the contention that in order for a taxpayer to be engaged in “exploitation,” the taxpayer must be engaged in the actual extraction and sale of the product.

\(^{20}\) Echo Bay Mines Ltd. v. The Queen, 92 DTC 6437 (FCTD).

\(^{21}\) Flanagan v. MNR, 89 DTC 615 (TCC).

\(^{22}\) Ludwig Wittgenstein (1889-1951) was an Austrian-born philosopher who is widely considered to be one of the most influential philosophers of the 20th century. In his later work, which is drawn upon here, Wittgenstein wrote with great insight on the uses of ordinary language. H.L.A. Hart (1907-1992) was an important 20th-century legal philosopher. He was professor
understanding of approaches to hybrid entities taken by the courts and tax authorities in Canada and the United Kingdom.

The Various Correct and Well-Established Applications of a General Term May Not Share a Fundamental Characteristic Common to All

There is among legal experts a deeply ingrained tendency to assume that if in common legal usage different things are capable of being referred to by the same term, this must be because of some “essential” or “fundamental” characteristic that they all have in common. There is an alternative view, however, which is that if A, B, and C are all referred to by the same term, it is not necessarily because of a shared essence but may instead be because A and B have features in common, B and C have some but not all the same shared features, and A and C share a still different set of features in common. The various instances are linked together by overlapping and criss-crossing commonalities of characteristics, and it may be that there is no irreducible set of core characteristics that they all share. In this alternative view, the various instances of a general term’s application would be linked by, as Wittgenstein called them, “family resemblances”—the reference here being to the way that traits are shared by and dispersed among members of a family: for instance, a girl has red hair and is short like her father and grandmother, while her brother, who is also red-haired, is tall like his blond mother. Despite having no single set of features in common, the various members viewed as a group may quite visibly belong to the same family. It can be helpful to think of various instances of a general term as being linked together by precisely such a network of criss-crossing similarities and differences.

Wittgenstein used the term “game” to illustrate his concept of family resemblances. We do not hesitate to use this term to name a wide variety of structured activities, often pursued for amusement: for example, card games, board games, of jurisprudence at Oxford University and is generally identified with the school of thought known as legal positivism.

Moreover, according to this “essentialist” mode of thinking, once identified, such fundamental characteristics may be considered to be a necessary and sufficient condition for the application of the general term in question. In the past, for instance, the CRA considered separate legal entity status to be a fundamental corporate characteristic that, as such, could be used as a touchstone to identify which entities are corporations for Canadian tax purposes. See Interpretation Bulletin IT-343R, “Meaning of the Term Corporation,” September 26, 1977, at paragraph 2: “As long as an entity has . . . separate identity and existence, the Department will consider such entity to be a corporation.” However, with the recognition that certain foreign, non-corporate entities (including some trusts and partnerships) are separate legal entities under local law, the CRA was forced to demote separate legal entity status from a “fundamental” to a merely “distinctive” corporate characteristic. See CRA document no. 2008-0284241C6, October 10, 2008.

Wittgenstein presented the concept of “family resemblances” and discussed its relevance to language in Philosophical Investigations (Oxford: Blackwell, 1953).
playground games, guessing games, video games, drinking games, etc. Within any one of these broad categories—card games, for instance—the various types of games are related to one another through different similarities and relationships, and indeed have many things in common. When one compares the individual games in one broad category to those in another, the differences increase in number and degree; for instance, many playground games require physical dexterity or agility, while fewer board games do. Also, the features that games of different types have in common vary in nature as we move from one game to another: for instance, luck plays a dominant role in some types of card games and a more limited one in billiards.25

One might take the view that if all these various activities are called “games,” it must be because they all have at least one irreducible element in common; for instance, in all of them, there is a concept of winning over an opponent. To this one might reply by pointing to the card game solitaire, or to the many single-player video games, in which the objective is not to win but rather to score as high a number of points as one can before elimination. Or perhaps winning is not the essential characteristic after all, but rather amusement? Well, what about war games conducted by a country’s military? Wittgenstein introduced the concept of family resemblances as a check on the dogmatic assumption of a common essence shared by all correct applications of a general category, replacing that assumption with an examination of the kinds of relationships, differences, and similarities that actually exist among the various applications.

The General Terms of Our Language Are Characterized by an Open Texture Rather Than Fixed Boundaries

In the Dunbar case,26 the court had to decide whether the shipping of crude oil constituted “exploitation” of a natural resource. In the context of commercial activities relating to natural resources, that term applies in plain cases—that is, cases where no one would dispute its application, such as drilling for, and extraction and processing of, resources. Then there are other upstream and downstream activities over whose status there might be reasonable disagreement. For example, does preliminary seismic drilling constitute exploitation of an oil field?27 Does reclamation of a mining site constitute exploitation of a mineral resource? Before the Dunbar

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25 Ibid., at paragraph 66.
26 Supra note 19.
27 The answer to this question depends partly on context; for instance, in a statutory provision that listed “exploration” alongside “exploitation,” there would be no need to ask whether seismic drilling should be placed in the latter category. Indeed, whether an exploratory activity like seismic drilling constitutes “exploration” for natural resources depends on the ultimate objective for which the drilling is conducted. In Larter v. The Queen, 2001 DTC 3673, the Tax Court of Canada ruled that a geological research ship that engaged in seismic testing to detect oil and gas was not exploring for petroleum, natural gas, or minerals, since it was deliberately trying to avoid drilling into oil or gas reserves in areas where it wished to conduct its primary scientific activity, which was to bore into parts of the ocean floor in order to identify areas of earthquake risk.
decision, did shipping of an extracted resource constitute exploitation? Like most of the terms found in tax legislation or treaties, the concept has what Hart termed an “open texture”: one may be able to identify standard instances or plain cases to which the term generally will apply; however, there may be uncertainty as to whether the term should be extended to activities that have only some of the features found in the plain cases. In such borderline cases, Hart observed, there are reasons both for and against the extension of the term’s application.

The uncertainty faced by courts in this type of situation may be reduced but not eliminated altogether. A court will ask, for instance, whether the borderline case is “sufficiently” like the plain case in “relevant” respects. In making this kind of determination, the purpose and context of the provision in which the term appears will provide considerable guidance. However, as most cases involving Canada’s general anti-avoidance rule show, purpose itself is usually not a given; legislative (or treaty-making) purpose must be identified through a process of interpretation that itself may contain much doubt and be subject to vigorous and reasoned disagreement that often can only be resolved by means of the gavel. Similarly with respect to context, a choice must be made as to which context is relevant (and other provisions that are identified as part of the relevant context must also in turn be interpreted).

On this view of language, the decision as to whether to apply a classifying term in novel circumstances involves some level of discretion: someone (a court, for instance) ultimately has to decide “which side of the line” the novel instance falls on, although it bears noting that there may be no line or boundary as such—until an authoritative body (such as a court) draws it in relation to specific potential applications of the term. The open texture of language allows the terms in statutes, treaties, or other legal instruments, where appropriate, to accommodate realities that may not have existed or at least been contemplated at the date when the relevant statute or treaty was drafted and came into effect. Thus, for example, in a case involving the classification of fibre optics transmission systems within a capital cost allowance class whose

28 The term “open texture” was used by H.L.A. Hart in The Concept of Law, 2d ed. (Oxford: Clarendon Press, 1994). The discussion of that concept here tracks closely Hart’s comments made in that work, ibid., at 15-16 and 126-27, as well as in “Positivism and the Separation of Law and Morals” (1958) 71:4 Harvard Law Review 593-629, at 607-8. For some of the intellectual history of the concept of “open texture,” see Brian Bix, “H.L.A. Hart and the ‘Open Texture’ of Language” (1991) 10:1 Law and Philosophy 51-72. Hart’s influential ideas have been the targets of many critics. One important, and in the tax context very valid, criticism of the concept of open texture is that in statutory interpretation one seeks to determine the meaning of entire provisions (in light of their objective), and not just the meaning of specific general terms found within those provisions, and that in light of the importance of context, Hart’s distinction between “plain cases” to which a general term always applies and “borderline” or “penumbral” cases often breaks down. See Lon L. Fuller, “Positivism and Fidelity to Law—A Reply to Professor Hart” (1958) 71:4 Harvard Law Review 630-72, at 661-69.

29 Hart, The Concept of Law, supra note 28, at 127.

30 Ibid. See also Wittgenstein, supra note 24, at paragraph 68.
terms had been chosen before such technology existed, the Federal Court of Appeal observed:

An open-textured interpretation is more in keeping with s. 10 of the *Interpretation Act* . . . according to which “the law shall be considered as always speaking.” As Hodgins, J.A. put it in *Re McIntyre Porcupine Mines Limited* (1921) . . . a word should be construed “so as to include that which, in the march of progress, falls properly within its ordinary meaning.”


### Countervailing Factors Constrain the Elasticity of Legal Language

While the ideas of Wittgenstein and Hart provide resources for understanding how the meaning of legal terminology can change and grow over time, it is also important to take note of the ways in which language can at times become less open-textured. After all, much of what courts do is to refuse to accept novel interpretations of a term or provision, even if there may be some arguments in favour of the broadening of meaning and even if language is elastic enough in principle to allow for the proposed broadening. Indeed, the elasticity of language is constrained by a number of (overlapping) factors, including context, purpose, and legal principles.

Although the role of context and purpose in statutory and treaty interpretation has been much discussed, it is helpful to consider briefly an example of how they can allow one interpretation to prevail over others in circumstances where semantics (the meaning of terms) alone does not allow one to rule out certain competing interpretations. When one speaks of the context of a provision, one may mean the surrounding text or one may mean something broader or less tangible, such as the “statutory scheme” of which the provision forms a part or the commercial practice or reality to which the provision applies. There may be indicators or clues found in one of these factors. For example, in *British Columbia Telephone Company v. The Queen*, 92 DTC 6129, at 6132-33 (FCA), MacGuigan JA identified some of the various facets of a contextual approach to statutory interpretation: “Four separate elements, in fact, may be distinguished within a ‘words-in-total context’ approach: the words themselves, their immediate context, the purpose of the statute as manifested throughout the legislation, and extrinsic evidence of parliamentary intent to the extent admissible. These elements are not always concordant, and a Court has the obligation of weighing them against each other in order to arrive at a proper construction.”

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31 *British Columbia Telephone Company v. The Queen*, 92 DTC 6129, at 6132-33 (FCA).
32 In *British Columbia Telephone Company*, ibid., at 6132, MacGuigan JA identified some of the various facets of a contextual approach to statutory interpretation: “Four separate elements, in fact, may be distinguished within a ‘words-in-total context’ approach: the words themselves, their immediate context, the purpose of the statute as manifested throughout the legislation, and extrinsic evidence of parliamentary intent to the extent admissible. These elements are not always concordant, and a Court has the obligation of weighing them against each other in order to arrive at a proper construction.”
contextual dimensions that will favour one interpretation of a provision over another. Thus, to take a familiar example, in *Ludco*, Iacobucci J declined to interpret the term “income” in subparagraph 20(1)(c)(i) of the Act to mean net income or profit, in part on the basis of the immediately surrounding text in that provision, which refers to “borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt) [emphasis added].” Iacobucci J interpreted the first instance of the word “income” in subparagraph 20(1)(c)(i) by reference to the second:

[W]hen one looks at the immediate context in which the term “income” appears in s. 20(1)(c)(i), it is significant that within the provision itself the concept of “income” is used in contradistinction from the concept of tax-exempt income. Viewed in this context, the term “income” in s. 20(1)(c)(i) does not refer to net income, but to income subject to tax. In this light, it is clear that “income” in s. 20(1)(c)(i) refers to income generally, that is, an amount that would come into income for taxation purposes, not just net income.

This kind of appeal to context is one of the devices by which a court can justify choosing between two competing interpretations of a term (gross versus net “income”), both of which could otherwise be considered to have merit if one took into account only the way that a term is generally understood and allowing for the open-textured nature of terms in general. The purpose of a provision or of an entire statute (or treaty) is another such device used by courts to limit meaning, as may be illustrated again by reference to *Ludco*:

Furthermore, reading “income” in s. 20(1)(c)(i) to mean income generally, as described above, is more consistent with the objective of the interest deductibility provision. . . . [T]he object of s. 20(1)(c)(i) is to create an incentive to accumulate capital with the potential to produce income by allowing taxpayers to deduct interest costs associated with its acquisition. . . . It is clearly sufficient for the purpose of the provision that an investor have a reasonable expectation of gross income . . . when investing borrowed money.

Taking into account the purpose of the interest deductibility provision, along with the context, thus assisted Iacobucci J in deciding to reject a reading of the term “income” that would equate it with “profit.” It is in ways such as these that context and purpose can be used to, so to speak, seal off the open texture of language. However, as mentioned, the identification of the relevant context and purpose will often

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34 Ibid., at paragraph 61.
35 Ibid., at paragraph 63.
itself require active argumentation and interpretation, and involve choices over which there may be legitimate disagreement.\textsuperscript{36}

Less attention has been paid in Canadian tax literature to the role of legal principles in circumscribing the process of interpreting tax legislation or a treaty. Ronald Dworkin, an American legal theorist, drew attention to the importance in judicial reasoning of legal principles, which he defined as a standard that is to be observed by legal decision makers because it is a requirement of justice or fairness or some other dimension of morality.\textsuperscript{37} Examples of principles that have been “observed” (that is, given some weight in reaching a decision) in tax cases would include the principle that a person cannot take advantage of his own wrong,\textsuperscript{38} the principle that similarly situated taxpayers should be taxed equally,\textsuperscript{39} or the famous principle that taxpayers are entitled to arrange their affairs so as to minimize the amount of tax payable.\textsuperscript{40} Dworkin contrasted legal principles to legal rules, which apply in an all-or-nothing

\textsuperscript{36} The determination of the purpose of a provision, and the use of such purpose once determined to interpret the language of the provision, is further complicated by the fundamental interdependence of our understanding of a provision/statute/treaty and our understanding of its purpose. An old treatise on legal interpretation refers to the “apparent contradiction . . . between the principle that words must be interpreted in the light of the intention expressed, and the other principle that the intention is to be ascertained from the words used in the document” (Roland Burrows, \textit{The Interpretation of Documents}, 2d ed. (London: Butterworths, 1946), at 6), a statement that nicely highlights the fact that the understanding of text often takes place with an implicit understanding of its purpose, while the determination of purpose cannot take place without an understanding of the text whose purpose is sought to be explained. Thus, although purpose can be described as something that can constrain the open-textured nature of language, this is not because purpose exists as something entirely external from the language being interpreted.


\textsuperscript{38} See, for example, \textit{The Queen v. Corsano et al.}, 99 DTC 5658, at 5662 (FCA), per Noël J (certain individuals who took on the role of directors of a corporation that failed to remit payroll source deductions could not invoke their lack of qualification as de jure directors to avoid a penalty under section 227.1 of the Act).

\textsuperscript{39} See, for example, \textit{Baker v. Canada}, 2005 FCA 185, in which the Federal Court of Appeal refused to adopt an interpretation of the expression “more than five full-time employees” (in the definition of “specified investment business” in the Act) that would define “full-time” employment (in particular, the number of hours required for “full-time” status) differently depending on the specific region and industry in question. A reason given for rejecting such a contextual approach is that it would contravene the principle that similarly situated taxpayers should be taxed equally.

\textsuperscript{40} See, for example, \textit{Stubart Investments Limited v. The Queen}, 84 DTC 6305, at 6325 (SCC), per Wilson J, rejecting a business purpose test on the basis that “[the Duke of Westminster] principle is far too deeply entrenched in our tax law for the courts to reject it in the absence of clear statutory authority.” Of course, statutory authority attenuating or qualifying the principle now exists, in the form of the general anti-avoidance rule in section 245 of the Act. See \textit{Canada Trustco Mortgage Co. v. Canada}, 2005 SCC 54, at paragraph 13. Indeed, unlike rules, legal principles are usually not overruled but may gradually fall out of fashion—witness principles that have fallen into desuetude, such as “taxation is clearly the rule and exemption the exception,” or the principle that clear words are required to authorize taxation and any doubt as to the meaning of the expression used should be resolved in favour of the taxpayer.
way, in the sense that if the rule is a valid one and the conditions for its application are met, the answer given by the rule must be accepted. In contrast, a principle as general as “a person cannot take advantage of his own wrong” does not set out conditions that make its application necessary. The principle provides a reason that, in appropriate circumstances, argues in one direction but does not necessitate a particular outcome, since it may be outweighed by other considerations (including other principles). Principles, like context and purpose, can in certain circumstances provide reasoned grounds for favouring one interpretation of a legal rule over another.

There is one legal principle in particular that serves to contain and constrain the open-ended nature of general terms highlighted above. Principles of statutory and treaty interpretation serve as overarching principles in judicial reasoning, and one such principle that is especially important in the tax context is the presumption of consistency of expression—that is, the presumption that Parliament uses language consistently so that within a statute or other legislative instrument the same words have the same meaning. This principle has particular weight when interpreting the Act, given that “a taxing statute is a highly technical piece of legislation which requires an interpretation that will ensure certainty for the taxpayer,”

41 Dworkin, supra note 37, at 24. This quality of legal rules is what Lord Cairns had in mind in Partington v. Attorney-General (1869), LR 4 HL 100, at 122, when he said, “[A]s I understand the principle of all fiscal legislation, it is this: if the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be” (cited in The Queen v. Malloney’s Studio Limited, 79 DTC 5124, at 5129 (SCC)). The view expressed by Lord Cairns remains a common way of conceiving of income tax law, and could be summarized, using Dworkin’s terms, as the view that tax law as such consists only of legal rules (set forth in tax legislation) and allows no scope for an outcome to be determined by policy, equity, or principle—other than the “principle” stated by Lord Cairns.

42 Dworkin, supra note 37, at 26. In a similar vein, discussing the weight to be given to a particular policy in interpreting a statute—and a policy is a near-cousin to a principle—the Federal Court of Appeal has recognized that while a particular policy may be relevant to the outcome of a case, that policy will have to compete with all other relevant policies: “[I]t must be recognized that where it is appropriate to consider matters of policy to assist in the interpretation of a statute, all relevant policy matters must be taken into account. It would appear from a review of Part I.3 as a whole that the avoidance of what the appellant refers to as double taxation is not the only policy consideration that may bear on the issues in this case.” Federated Co-operatives Limited v. The Queen, 2001 DTC 5414, at 5417 (FCA), per Sharlow J.

43 Dworkin used the concept of legal standards (both principles and policies embedded in law) to oppose the concept of judicial discretion favoured by Hart and discussed above. In Dworkin’s view, when a court has to decide a hard case, it does not exercise discretion (in the strong sense of unconstrained judgment) between different plausible interpretations of an expression, but rather will draw on these standards to reach a decision.

44 Mattabi Mines Ltd. v. Ontario (Minister of Revenue), [1988] 2 SCR 175, at paragraph 20, per Wilson J.
and predictability being especially important given our self-assessment system. The presumption of consistency of expression has relevance to the interpretation of terms that may be applied to hybrid entities, favouring, as it does, an interpretation of terms like “partnership” and “corporation” that gives them the same meaning wherever found in an enactment. The presumption lends a conservative tendency toward the interpretation of these terms that will disfavour the kind of ad hoc adjustment or expansion of their meaning to suit a particular occasion that might otherwise have been made possible by the open-textured nature of language.

The presumption of consistency of expression, however, is rebuttable; it competes for predominance, in some cases, with the contextual principle; and it arguably has less weight in the interpretation of a tax treaty than in the interpretation of the Act. A tax treaty is drafted with much less technical precision than the Act and, it has been said, must be interpreted in a liberal manner so as to give effect to the intention of the contracting states with respect to the particular type of income or treaty provision being considered.

**APPROACH TO FOREIGN ENTITIES IN A TREATY CONTEXT**

The two concepts of family resemblances and open texture can be viewed as accounting in part for what can give rise to parties’ (and different judges’) validly reaching conflicting results in the interpretation of legal terms in particular cases. Those two aspects of language are particularly useful in illuminating what it is that courts do when they apply the provisions of a tax treaty to a foreign hybrid entity. For instance, when a Canadian judge is called upon to determine whether an unfamiliar entity is a “company,” it is well to recall what those entities that to date have generally been accepted as corporations for Canadian tax purposes have in common, and to recognize how they may also differ from one another. As one surveys such entities—an ordinary Canadian corporation, a Nova Scotia unlimited liability company, a Quebec syndicate of co-owners, a Madagascar société à responsabilité

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45 See *Tolhoek v. The Queen*, 2006 TCC 681, at paragraph 30, per Campbell J (aff’d. 2008 FCA 128): “Although there is a presumption of consistent expression, which, as a basic principle of statutory interpretation, requires giving the same words the same meaning throughout a statute, the weight afforded to this presumption varies because words in a statute may have different meanings depending on the context in which they are used.”

46 The presumption of consistent expression “conflicts to some extent with the contextual principle in interpretation, which emphasizes that meaning is dependent on context.” Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Markham, ON: Butterworths, 2002), at 222.

47 See *Gladden Estate v. The Queen*, 85 DTC 5188, at 5191 (FCTD): “[A] tax treaty must be given a liberal interpretation with a view of implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated *insofar as the particular item under consideration is concerned* [emphasis added].”


49 See CRA document no. 9M19160, November 30, 1999.
limitée—similarities appear, disappear, and re-emerge. If what links those various usages are overlapping but not universally shared common characteristics, then when a court encounters an unfamiliar entity that has only some of the usually concomitant characteristics of recognized corporations and perhaps contains significant differences, then if a decision is made to call the new entity a corporation, it may well be because that entity is related to the existing types of corporations in the same way that they already relate to one another—by family resemblances, not an irreducible common essence.

Like the term “game,” therefore, the terms used in tax treaties to refer to various types of business entities may be considered to have an open texture, and the decision as to whether to apply such terms to a particular instance will need to be bounded by considerations of context, purpose, and, at times, legal principles. That, in any event, is the proposition being advanced here. In order to test this proposition’s validity, the remainder of this article examines three cases—two from the United Kingdom, Memec and Swift, and a Canadian case, TD Securities—in which a court encountered a foreign entity that had no exact counterpart in domestic law and was required to apply treaty provisions to the profits earned through or by the entity.

Memec: Entity Comparison, Not Classification

Memec, a 1998 decision of the UK Court of Appeal, is often referred to, in Canada at least, as illustrating the English courts’ approach to entity classification. However,

51 See Wittgenstein, supra note 24, at paragraph 66. The Act nowhere says that an entity formed under the Canada Business Corporations Act is what is meant by the term “corporation,” and it therefore seems possible to interpret the term by reference to entities whose corporate status has been agreed upon (having due regard to possible differences arising from variations in the constating documents of a particular type of entity).
52 This is not to say that courts cannot choose to lay down minimal conditions that must be met in order for a term in its technical legal usage to apply; for instance, although in ordinary usage an “agent” may include a representative with no authority to enter into legal relations on behalf of the represented person, it is perfectly within the power of the courts to require the presence of such legal authority as a minimal condition for the term’s application in income tax matters. Something of this sort can be seen as occurring in Pullman v. The Queen, 83 DTC 5080 (FCTD), where the issue was whether a non-resident moneylender was carrying on business in Canada, in large part on the basis of the activities of a Canadian agent/broker. While admitting that the term “agent” is “very wide and nebulous,” such that it can refer simply to “one who acts for somebody else” (ibid., at 5082), the court thought that the kind of agency required by the Act had to be the kind where there is a power to bind the principal. To take another example, while the ordinary, non-legal meaning of a “sale of goods” may encompass the transfer for consideration of goods as part of a contract for work and materials (for example, in construction), the courts may have good reasons for taking the position that for the purposes of the Act, such bundled transfers will generally not constitute a “sale of goods.” See the majority decision in Will-Kare Paving & Contracting Ltd. v. Canada, 2000 SCC 36.
53 Supra note 2.
54 See, for example, CRA document no. 2008-0266251I7, April 15, 2008.
a close examination of the reasoning in the case suggests that something analogous to, but significantly different from, entity classification was involved—the identification of family resemblances among different types of UK partnerships and the use of these, not to determine whether the foreign (German) business association at issue should be considered a partnership for UK tax purposes, but to serve a different purpose, grounded in the application of a tax treaty to a particular item of income.

_Memec_ involved an agreement formed under German law between a UK corporation, Memec plc, and its wholly owned German corporate subsidiary, Memec GmbH, to form a “silent partnership” (*stille Gesellschaft*). Memec GmbH, the owner of the business of the silent partnership arrangement, was a holding company that owned two German corporate subsidiaries. The trading profits of the subsidiaries were distributed in the form of dividends to Memec GmbH, which in turn paid dividends to its parent, Memec plc. As earned and distributed up the chain, these profits were subject to multiple levels of German taxation, and to UK corporation tax when received by Memec plc, which was entitled to 87.4 percent of the profits from the silent partnership arrangement.

The UK-Germany tax treaty allowed a UK resident to claim an indirect foreign tax credit for German tax imposed on the profits of a corporation paying dividends to the UK resident. Memec plc wished to claim a credit against its UK tax liability for German trade tax imposed on the two subsidiaries. It is worthwhile pausing for a moment to reflect on what the UK taxpayer was asserting: that the agreement of silent partnership had the far-reaching effect of converting (at least a portion of) the dividends paid to the sole owner of the shares of the subsidiaries, Memec GmbH, into dividend income of the shareholder of Memec GmbH, namely, Memec plc. To succeed in making good that claim, the court said, the taxpayer had to establish that the silent partnership is properly to be regarded as transparent, so that plc as the silent partner is to be treated for United Kingdom corporation tax purposes as entitled to a share of the dividends paid by the subsidiaries.

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55 The features of a silent partnership were described by the trial judge as follows: “The essential points are that the silent partner . . . makes a capital contribution to a commercial enterprise run by another person who is designated as the owner . . . The owner remains the owner of the business assets, and of the income from those assets as it accrues. The silent partner has no proprietary interest in the assets but has a contractual right to payment of his share of the annual profits (if any). . . . The owner runs the business. . . . The silent partner is not responsible for liabilities of the partnership beyond the amount of his contribution, but his share of any loss will be debited to his contribution, and must be made good out of his share of profits of later years before any share of profits is distributed to him. . . . A silent partnership has no separate legal personality under German law.” _Memec v. IRC_, [1996] STC 1336, at 1345 (Ch. D.).

56 Article XVII(1)(b) of the Convention Between the United Kingdom of Great Britain and Northern Ireland and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, signed at Bonn on November 26, 1964, as amended by the protocol signed on March 23, 1970 (herein referred to as “the UK-Germany treaty”).

57 _Memec_, supra note 2, at 763.
The operative concept in Memec, transparency, was not found in the statutory or treaty provisions before the court, but rather is shorthand for a particular result under the UK taxing statute and, in this case, the UK-Germany treaty: income of a “transparent” entity/arrangement is income that can be treated, for purposes of that statute and treaty, as allocable to the members of the entity or the parties to the arrangement. In the case of the dividends paid by the subsidiaries of Memec GmbH, it was necessary that the silent partnership be considered transparent in order for the foreign tax credit rules in the treaty to provide the double taxation relief sought by Memec GmbH’s silent partner, Memec plc.

It is in the context of determining whether the dividends from the trading subsidiaries could be treated as paid to Memec plc in light of the silent partnership arrangement that the Court of Appeal looked to analogies with partnerships formed under English and Scottish law. Having noted that such partnerships are treated as fiscally transparent for UK corporation tax purposes, the court said that, in evaluating Memec plc’s claim that as silent partner it derived the dividends paid by the German subsidiaries, its task was to

consider the characteristics of an English or Scottish partnership which make it transparent and then to see to what extent those characteristics are shared or not by the silent partnership in order to determine whether the silent partnership should be treated for corporation tax purposes in the same way.

The court did not say that its task was to identify every possible characteristic of an English or Scottish partnership, or even the essential features of such partnerships; rather, it had to identify the particular characteristics of those forms of business association that allowed them to be treated as transparent for UK tax purposes. The objective of such an initial inquiry, the court said, was to see to what extent the German silent partnership shared such characteristics, so as to justify its being similarly treated. In other words, the court did not see it as its role to determine whether a German silent partnership should be classified as a “partnership” within the meaning of UK tax law (or even the UK-Germany treaty); rather, it was to determine whether, like an English or Scottish partnership, the silent partnership should be treated as fiscally transparent. Put in stark terms, Memec is not an entity classification case, in the sense of attaching the name of a known domestic type of entity to a foreign arrangement.

Without using the term “family resemblances,” the Court of Appeal in Memec took an inventory of the transparency-related features shared, and sometimes not shared, among different entities whose UK tax transparency was well established, namely, English general partnerships, English limited partnerships, and Scottish

58 Article XVIII(1)(b) of the UK-Germany treaty applied to “a dividend paid by a company which is a resident of the Federal Republic to a company which is a resident of the United Kingdom.”
59 Memec, supra note 2, at 764.
partnerships. That analysis parallels the discussion above of the ways in which different instantiations of a common term (such as “games”) are linked. The court listed five “relevant characteristics” of an English general partnership—relevant in the sense that they could be considered as justifying treating the partnership as fiscally transparent:

(1) the partnership is not a legal entity; (2) the partners carry on the business of the partnership in common with a view to profit . . . ; (3) each does so both as principal and . . . as agent for each other, binding the firm and his partners in all matters within his authority; (4) every partner is liable jointly with the other partners for all debts and obligations of the firm . . . ; and (5) the partners own the business, having a beneficial interest, in the form of an undivided share in the partnership assets . . . , including any profits of the business.  

The court did not say that all of these characteristics must be present or be present in the same way in order for other forms of business organization to be similarly treated. It noted that in the case of an English limited partnership, two of the five attributes were present in a straightforward way, while three had to be modified to reflect the unique features of limited partnerships. The characteristics of a Scottish partnership were more difficult to line up with the five relevant features of the English general partnership. Particularly challenging in this regard was the complete absence of two important attributes of an English partnership supporting “transparent” treatment: unlike an English partnership, a Scottish partnership is a separate legal entity, and the assets of the partnership are vested in the partnership both legally and beneficially. The majority judgment found a way to finesse these distinctions, based on the “substance” or the “real” relation of Scottish partners to the profits of the partnership. The comparative review of different types of UK partnerships in Memec highlights the open texture of the partnership concept, embracing as it does forms of business association that both resemble and differ from one another in significant ways. To paraphrase Wittgenstein, one could go through still other entities that may be called partnerships in other jurisdictions and see how similarities crop up and disappear.

The elasticity of a concept, however, does not mean that it will apply to every form of business association imaginable. In determining whether a German silent partnership shared the characteristics relevant to UK fiscal transparency to a sufficient extent, the court found that the silent partnership was even further removed than a Scottish partnership from sharing such characteristics. A silent partner’s interest in partnership profits is purely contractual; since the business is that of the owner, no business is carried on by the silent partner and the owner in common; and the members of the silent partnership are not jointly liable for the debts and obligations incurred by the owner in conducting the silent partnership’s business. The characteristics of the silent partnership were found to be insufficiently weighted in favour

60 Ibid.
of transparent treatment, and it could therefore not be said for the purposes of the foreign tax credit provisions of the UK-Germany treaty that the dividends declared by Memec GmbH’s wholly owned subsidiaries were “paid to” Memec plc.

The approach toward foreign business associations adopted in Memec in the context of applying a particular treaty provision to a specific set of facts was subsequently generalized by the UK tax authorities, which published guidelines for the categorization of foreign entities as either “transparent” or “opaque.” Those guidelines list a set of six factors to be considered in determining whether an entity ought to be considered transparent with respect to a particular item of income. The approach is parallel to but different from that of Canadian tax authorities, which is to review and evaluate similar factors in order to classify the entity as a partnership, corporation, trust, or contractual/co-ownership arrangement. It may be said that the two approaches are really not so different, since they both involve classification (with the more basic categories of “transparent” and “opaque” being utilized in the United Kingdom, rather than a list of domestic entities). However, in the treaty context, it may be that the UK approach allows the focus and objective of the classification or comparison exercise to be placed more on determining the relations among the source-country income, the entity, and its members, than on forcing foreign entities into often ill-fitting categories. In other ways, there are deep similarities between the two approaches insofar as both rigorously focus on the local-law characteristics of the foreign business arrangement in order to arrive at certain conclusions under domestic (that is, UK or Canadian) law about who is ultimately accountable for an item of income or loss. In this respect, the Canadian approach perhaps relies more than the UK approach on the open-textured nature of language (insofar as the boundaries of what constitutes a corporation, partnership, or trust

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61 See United Kingdom, HM Revenue & Customs (HMRC), *International Manual* INTM180010, “Foreign Entity Classification for UK Tax Purposes,” which lists the following questions as relevant to the classification of a foreign entity (that is, whether it is either opaque or transparent) for UK tax purposes:

a. Does the foreign entity have a legal existence separate from that of the persons who have an interest in it?

b. Does the entity issue share capital or something else, which serves the same function as share capital?

c. Is the business carried on by the entity itself or jointly by the persons who have an interest in it that is separate and distinct from the entity?

d. Are the persons who have an interest in the entity entitled to share in its profits as they arise; or does the amount of profits to which they are entitled depend on a decision of the entity or its members, after the period in which the profits have arisen, to make a distribution of its profits?

e. Who is responsible for debts incurred as a result of the carrying on of the business: the entity or the persons who have an interest in it?

f. Do the assets used for carrying on the business belong beneficially to the entity or to the persons who have an interest in it?

HMRC says that, generally, particular weight should be placed on factors c and d.
are continually being remapped or tested, as new foreign entities are sought to be encompassed within such categories).

**Swift: Weighted Entity Comparison**

*Swift*, recent decision of the UK First Tier Tribunal (Tax), builds on *Memec* in according entity classification a subordinate role within a broader process of treaty interpretation, in which the fundamental task is to establish the true relation between income and a particular treaty resident.

Briefly stated, the facts in *Swift* were that an individual who was resident (ordinarily resident, but non-domiciled) in the United Kingdom for UK tax purposes was a member of a Delaware limited liability company (LLC) that was treated as a partnership for US tax purposes. The LLC generally distributed each member’s share of profits and net gains shortly after year-end. US tax applied to the taxpayer’s allocable share of the net income of the LLC that was effectively connected with a US trade or business. The taxpayer reported the same amount on his UK tax return as partnership income. In effect, the taxpayer would be paying UK and US tax on the same amount and sought double taxation relief under the UK-US tax treaty, which required the United Kingdom to provide a credit against UK tax “computed by reference to the same profits or income by reference which the United States tax is computed.”

The issue therefore was whether the US tax and the UK tax were computed by reference to the same profits or income. HM Revenue & Customs (HMRC) took the position that the taxpayer was taxed in the United Kingdom on a separate source of income, one that derived from his rights as a member under the LLC agreement.

John F. Avery Jones wrote the decision for the tribunal, and this decision is currently under appeal. The tribunal found for the taxpayer on the basis of two related

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62 Supra note 3.

63 Article 23(2) of The Convention Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed at London on December 31, 1975, as modified by subsequent notes and protocols (herein referred to as “the 1975 UK-US treaty”). The taxpayer relied on the 1975 UK-US treaty for the years of assessment 1997-98 to 2002-3. For the 2003-4 year of assessment, the taxpayer relied on article 24(4) of the 2001 UK-US treaty, which was not materially different from article 23(2) of the 1975 treaty: see the Convention Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America 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 July 24, 2001, as amended by the protocol signed on July 19, 2002 (herein referred to as “the 2001 UK-US treaty”). Although the 2001 UK-US treaty contains a provision dealing with income derived through fiscally transparent entities (article 1(8)), it does not appear that this provision shed any additional light on the issue before the tribunal.

64 HMRC in this regard was trying to invoke the reasoning that prevailed in *Memec*, in which the court found that Memec plc’s source of income was not the shares of the operating subsidiaries but rather the silent partnership agreement.
but distinct lines of reasoning. HMRC framed the case in terms of its Memec-based guidelines on entity classification, arguing that if the court agreed, on the basis of those guidelines, that the LLC was fiscally opaque, then the taxpayer would not be entitled to UK tax relief for US tax. In effect, HMRC was inviting the tribunal to classify the LLC as transparent or opaque. However, the tribunal did not find this to be the most directly relevant line of inquiry, given that the treaty did not refer to transparency or opacity:

The issue is whether the UK tax is [in the words of the treaty] “computed by reference to the same profits or income” or whether [the taxpayer] is taxable on the equivalent of a dividend. Asking whether SPLLC is transparent or opaque may be another way of asking the same question but we consider that it is preferable to apply the words of the Treaty.\footnote{Swift, supra note 3, at paragraph 18 (emphasis added).}

The tribunal may be taken to be saying that entity classification is not an abstract exercise, unconnected to the specific treaty language at issue. The relevant treaty provision did not require that the LLC be classified as transparent or opaque (or, if applied in a Canadian context, as a partnership or corporation); instead, it required only that the taxes in both countries be computed by reference to the same income or profits. On the basis of a close reading of the LLC agreement and the Delaware LLC statute, Avery Jones J concluded that as a legal matter, the profits of this particular LLC belonged to the members as those profits arose, a finding that in itself supported the holding in the case that the treaty conditions for a UK foreign tax credit were satisfied.

However—and understandably, in light of existing Court of Appeal authority—the tribunal may have hesitated to jettison entity comparison of the sort conducted in Memec and, in its second line of reasoning, considered the results of applying the Memec approach to the particular LLC.\footnote{See ibid., at paragraph 20: “Although we have said that we prefer to concentrate on the words of the Treaty rather than ask whether SPLLC is transparent or opaque, we shall apply the Memec approach to it.”} Taking into account the legal attributes considered in Memec and by HMRC in determining whether an entity is fiscally transparent or opaque, the tribunal found that under Delaware law for this particular LLC, there were indicia of both opacity and transparency. On the one hand, it was the LLC, and not the members, that carried on its business as principal; it was the LLC, and not the members, that was liable for its debts and obligations; and it was the LLC, and not the members, that owned the business. On the other hand, the LLC did not have share capital, and the members were entitled to the profits as they arose.\footnote{The tribunal’s findings of fact in Swift (for instance, that the LLC in question did not have share capital) were not intended to be interpreted as applying to all Delaware LLCs. The tribunal cautioned (ibid., at paragraph 17) that “we are concerned with whether relief applies in relation to the profits of this particular Delaware LLC, SPLLC, which, since there is wide freedom to contract the terms of a Delaware LLC, may not be of general application [emphasis added].”}

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In these circumstances, one could say, with Hart, that there are good reasons for calling the LLC transparent and good reasons for calling it opaque, but none that compel that only one of the two answers be the correct one; or one might say, with Wittgenstein, that this LLC bears resemblances to both the opaque and the transparent families of entities, sharing but also lacking some of the features of members in both categories. Instead of floundering in classificatory indeterminacy, however, the tribunal found a way out. It acknowledged that there was a spectrum of entities running from the clearly transparent (English partnership) to the clearly opaque (UK company), with a Scottish partnership falling somewhere in between. The Scottish partnership is a legal person that owns the assets and incurs the liabilities of the business (with the partners having secondary liability), but the partners carry on business together and are entitled to the profits of that business. By longstanding consensus, this hybrid entity (the Scottish partnership) had already been placed for UK tax purposes on the fiscal transparency end of the spectrum. The tribunal found a place for the particular LLC within this spectrum, between a UK company and a Scottish partnership, notably differing from the latter in that the entity itself carried on business without liability to the members but resembling it insofar as the members were entitled to profits as they arose. The fact that the LLC shared attributes with both a transparent entity (a Scottish partnership) and an opaque one (a UK company) did not answer the question of which side of the dividing line it should be placed on. Here, the court made a decision: “Since we have to put it on one side of that dividing line we consider that it is on the partnership side particularly in relation to its income.”

The qualification at the end of the tribunal’s statement (“particularly in relation to its income”) brings together the two strands of reasoning in the judgment. Indeed, the very next statement is to the effect that the factor that was of main concern in the appeal in relation to the treaty was whether the profits belonged to the members as they arose. After all, the issue posed by the UK-US treaty was whether the UK tax was “computed by reference to the same profits or income” as the US tax. The fact that this was the question posed by the UK-US treaty served to orient the entity comparison exercise, allowing the tribunal to give greatest weight, in considering the relevant features of the LLC, to one of the factors indicating transparency (the profits belonging to members as they arose) and less weight to the factors indicating opacity, because the former was the factor that most directly bore on the question that the double taxation relief article posed.

Extrapolating from the court’s findings in Swift, the reasoning suggests that if a different treaty provision had been at issue, the particular LLC considered in the case might not have been treated as transparent for UK tax purposes. For instance, if the LLC had wholly owned a UK corporation that paid dividends and a US-resident corporate member of the LLC had tried to claim entitlement to a 5 percent UK withholding tax rate under article 10(2) of the UK-US treaty, perhaps the court would not

68 Ibid., at paragraph 20.
have treated the LLC as transparent. In order for the low withholding tax rate to apply, one would have to conclude that the LLC’s member owned the shares of the UK corporation legally owned by the LLC—a conclusion that would be difficult to reach on the basis of Delaware law. Thus, it may well be that in such circumstances, the LLC would not have been treated as transparent for the purposes of a different treaty provision than the one at issue in Swift. This result would not be inconsistent with the principle of uniformity of expression that courts often apply, since (as noted by Avery Jones) the UK-US treaty does not in fact use the term “transparent,” and it presents very differently worded tests in the articles relating to dividends and foreign tax credits—the question being, in the former case, whether shares are owned by a resident and, in the latter case, whether two countries’ taxes are computed by reference to the same income or profits. There is thus no obstacle in the wording of the treaty to treating a hybrid entity like the LLC in Swift as transparent for some treaty purposes and not for others, an approach that indeed is not inconsistent with Canadian principles of treaty interpretation. According to Gladden, for example, treaties must be interpreted in a liberal manner, so as to achieve the contracting states’ intentions with respect to “the particular item under consideration.”

Of course, caution would need to be exercised before deciding that such a highly contextual approach of the sort observed in Swift should be transposed to the interpretation of terms like “corporation” or “partnership” appearing in the more detailed and technical provisions of a taxing statute. Those terms do tend to appear frequently in tax legislation, and any attempt to give great weight to the purpose of the particular statutory provision being applied in a particular instance would have to contend to a greater extent than in the case of a treaty with the presumption of uniformity of expression.

**TD Securities: Expanding the Meaning of “Resident”**

A Delaware LLC was also the source of interpretive and classificatory difficulty in TD Securities, a recent decision of the Tax Court of Canada. In its attempt to resolve a perceived “tension between the ordinary meaning of the terms used in the treaty and [the treaty’s] object and purpose” resulting from the application of the term “resident” to a hybrid entity, the decision can be seen as deepening and expanding the meaning of that term for the purposes of Canada’s tax treaties in a manner that underscores the open texture of language.

The case involved TD Securities (USA) LLC (“TD LLC”), a Delaware LLC that was based in and did business primarily in the United States but also had Canadian branch operations. For US federal income tax purposes, since TD LLC was generally a “disregarded entity,” all of its income (which included income from the Canadian

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69 See supra note 47, citing the court’s statement at 5191.

70 Supra note 4.

71 Ibid., at paragraph 51.
branch) was included in computing the income of its sole member, TD Holdings II Inc. (“Holdings II”), which was a US corporation. The income of Holdings II was in turn included in the consolidated return of TD USA, a US corporation that was the sole shareholder of Holdings II.

At issue in the case was the applicable rate of Canadian branch tax on the net after-tax income of TD LLC’s Canadian operations. In addition to taxing a US-resident company on income attributable to a Canadian permanent establishment, Canada is permitted under the Canada-US tax treaty to impose its branch tax on a US-resident “company” but only at the treaty-reduced rate of 5 percent (rather than the statutory rate of 25 percent). Both the Canadian tax authorities and the taxpayer took the position that TD LLC was a corporation for Canadian tax purposes—in other words, entity classification was not at issue. It may be taken as an indication of the flexibility of both the LLC form and the concept of a “corporation”/“company” that the consensus in this case (that the Delaware LLC was a corporation) was arguably contrary to the finding in Swift (that the Delaware LLC was more like a Scottish partnership than an English corporation, at least in relation to its income).

The key question before the Tax Court was whether TD LLC was a “resident” of the United States for treaty purposes—that is, whether it was a person that was “liable to tax therein by reason of that person’s domicile, residence, citizenship, place of management, place of incorporation or any other criterion of a similar nature.”

The Crown took the position that a fiscally transparent LLC is not “liable to tax,” or at least is not so by virtue of any of the acceptable criteria. According to the Crown, “the meaning of the phrase resident of a Contracting State set out in the US Treaty is clear and unambiguous and . . . the evidence is clear that TD LLC was not itself liable to tax in the US.” Had the court agreed that the meaning of “resident” and “liable to tax” was unambiguously clear, it might have simply said that TD LLC was no more liable to tax in the United States than a Delaware partnership (that has not “checked the box” to be treated as a corporation) and have found against the taxpayer. The court, however, refused to adopt a plain meaning approach to the phrase “liable to tax.”

In order to establish a framework for factoring into its analysis a wide variety of sources relevant to the meaning of the terms “resident” and “liable to tax”—sources that would call into question the “clear and unambiguous” meanings advocated by the Crown—the court made two preliminary moves. First, it considered the Vienna

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72 Article X(6) of 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, March 17, 1995, and July 29, 1997 (herein referred to as “the Canada-US treaty”). The fifth protocol to the treaty, signed on September 21, 2007, came into force after the periods under review in this case.

73 But see TD Securities, supra note 4, at paragraph 33, where the court makes a statement as to why TD LLC should be considered a “company” for the purposes of the Canada-US treaty.

74 Article IV(1) of the Canada-US treaty.

75 TD Securities, supra note 4, at paragraph 22.
Convention on the Law of Treaties,\(^76\) which framed the court’s task as interpreting the Canada-US treaty in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. The court noted that in ascertaining the purposes of a treaty, a court may refer to extrinsic materials that form part of the legal context, without the need to first find an ambiguity before turning to such materials.\(^77\) On this basis, the court opened the door to considering the object and purpose of the parties to the treaty (that is, the United States and Canada) in light of a broader context, involving the approach of the two countries to various types of entities that are explicitly or by consensus treated as “liable to tax,” and bringing this to bear on the interpretation of article IV(1) as applied to a fiscally transparent LLC.

The second preliminary move made by the court was to establish a legal principle for mediating among the various types of entities (of varying degrees of fiscal transparency) to which the Canada-US tax treaty may apply. Much of the judgment is occupied with building up the relevant context of article IV(1) so as to identify the two countries’ intent. As part of this exercise, the court considered how partnerships, trusts, S corporations, governmental entities, pension funds, and charities are treated under the residence article in the Canada-US treaty. In the case of income received by all of these entities, either the entity or its members could be treated as a “resident” recipient of the income for treaty purposes by the two countries. The court found that the only “anomaly” was the Canadian tax authorities' treatment of fiscally transparent LLCs, insofar as treaty relief had been denied by Canada at both the entity and the LLC member level. The court could have decided to let the anomaly stand—simply because of the hybrid nature of an LLC and the resulting technical difficulties of assimilating it to established Canadian statutory and treaty tax categories. However, the court invoked a legal principle of the sort discussed above in order to treat the elimination of such inconsistency as a goal to be worked toward: it expressed the view that the provisions of international tax treaties must be interpreted in order to achieve consistency, predictability, and fairness.\(^78\) While the first of the two preliminary moves identified here—establishing the necessity of considering a broad legal context to interpret article IV(1)—allowed the court to treat as relevant a gamut of tax-exempt and fiscally transparent entities, the second move—establishing consistency as a guiding principle—provided a means of having this context seem to compel or justify a particular result (namely, the elimination of the anomalous Canadian tax treatment of LLCs).

Having established the interpretive parameters for the analysis, the court identified as part of the relevant context for interpreting article IV(1) a variety of more and


\(^{77}\) TD Securities, supra note 4, at paragraph 55, citing Crown Forest Industries Ltd. v. Canada, [1995] 2 SCR 802 as support for that proposition.

\(^{78}\) TD Securities, supra note 4, at paragraph 57, citing Canada Trustco Mortgage Co., supra note 40, in connection with this principle.
less authoritative sources relating to a number of types of entities. It took into account amendments to the Canada-US treaty (including one that postdated the tax years in issue), US Treasury department technical explanations of such amendments, the 1999 OECD partnership report,\textsuperscript{79} OECD commentaries, and the administrative practice of the tax authorities in each of the two countries. Synthesizing these various sources, the court found with respect to entities that are treated as fiscally transparent in at least one of the two states (such as an S corporation or a partnership) that the countries had always clearly intended that the income of such an entity would be entitled to treaty relief, provided that the residence state exercised jurisdiction to tax the income at either the entity or the member level. It also asserted that “Canada must consider as part of the context”\textsuperscript{80} of interpreting the residence article of a tax treaty that its treaty partner may tax income of a hybrid entity at a different level than Canada would. The basis for this assertion appears to be, at least in part, a legal principle enunciated in a passage from the OECD commentary to the model treaty cited earlier in the decision, namely,

the principle . . . [that] the State of source should take into account, as part of the factual context in which the Convention is to be applied, the way in which an item of income, arising in its jurisdiction, is treated in the jurisdiction of the person claiming the benefits of the Convention as a resident.\textsuperscript{81}

As mentioned, legal principles (assuming that Boyle J of the Tax Court and the OECD have in fact identified a valid principle) do not compel a particular result, but where applicable are required to be taken into consideration. The language used here—“must consider” and “should take into account”—is consistent with that view.

In Boyle J’s view, the purpose, context, and principles that he identified favoured an interpretation of article IV(1) that would entitle TD LLC to the benefits of article X(6) of the Canada-US treaty. Following the principle that Canada must take into account as part of the relevant context the residence state’s jurisdictional prerogative to select the level at which its own tax is to be imposed, the court observed that US tax law provided that the income of TD LLC would be fully and comprehensively taxed to its member, Holdings II (whose income was consolidated in the TD USA tax return). Thus, the court stated, US tax law

comprehensively taxes the worldwide income of TD LLC as fully as if it had been earned by any other entity including a US domestic corporation. . . . [i]n such a case, it seems clear that the income of TD LLC should enjoy the benefits of the US Treaty.\textsuperscript{82}


\textsuperscript{80} \textit{TD Securities}, supra note 4, at paragraph 98.

\textsuperscript{81} Ibid., at paragraph 62, quoting from paragraph 6.3 of the commentary on article 1 of the OECD model treaty, supra note 10.

\textsuperscript{82} \textit{TD Securities}, supra note 4, at paragraph 97.
However, there remained an obstacle to TD LLC’s enjoyment of treaty benefits, and that was the language used in article IV(1) of the Canada-US treaty. Notwithstanding the manner in which the court framed the context and purpose of article IV(1), when one turns to the text, could it really be said that an entity that was disregarded under the tax laws of the United States was itself “liable to tax therein by reason of that person’s domicile, residence, citizenship, place of management, place of incorporation or any other criterion of a similar nature”? The OECD commentary, which the court in other respects treated as reflecting the intention of Canada and the United States, posed a challenge in this regard, since it asserts that a partnership that is treated as fiscally transparent by a residence state for that very reason cannot be considered to be liable to tax therein. In the residence state here, the United States, the LLC was treated in the same way as such a partnership. The court took an oblique path toward resolving the seeming tension between what it took to be the fair and consistent result in this case and the manner in which liability to tax had hitherto been interpreted in respect of partnerships. It noted two examples, one being the OECD commentary and the other being the 2007 protocol to the Canada-US treaty, in which the liability to tax of an entity that is fiscally transparent in the residence state is disavowed, only to be followed up by an injunction that relief may nonetheless be administratively delivered at the entity level on the basis of the liability to tax of the members of the entity. The court argued that technically this does not work: the source state treats such a hybrid entity as a taxpayer under its domestic statutory scheme, and if the entity is not liable to tax under the laws of the residence state, that entity arguably is not entitled to invoke the treaty. The pragmatic willingness of the OECD and of the US and Canadian tax authorities to allow the entity to claim treaty benefits vicariously, on the basis of the derivation of the relevant income by resident members of the entity, demonstrates the intention of the contracting states that treaty benefits should apply. However, no basis in the language of a treaty had hitherto been articulated by the courts as the grounds for delivering such benefits.

In these circumstances, the court took the bold step, or leap, of adopting a clear if unprecedented position as to how article IV(1) of the Canada-US treaty applies to a fiscally transparent LLC:

83 Paragraph 8.7 of the commentary on article 4 of the OECD model treaty, supra note 10.
84 In the case of the fifth protocol, the administrative solution is provided not in the treaty itself but in the US Treasury technical explanation: Department of the Treasury Technical Explanation of the Protocol Done at Chelsea on September 21, 2007 Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital Done at Washington on September 26, 1980, as Amended by the Protocols Done on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997, commentary on paragraph 6 of article IV (article 2 of the protocol).
85 With respect to this aspect of the reasoning in TD Securities, the objection has been made that an entity may have standing to assert entitlement to treaty benefits without itself being a treaty resident. See Marc Darmo and Angelo Nikolakakis, “The New Rules on Limitation on Benefits and Fiscally Transparent Entities,” in Report of Proceedings of the Sixty-First Tax Conference, 2009 Conference Report (Toronto: Canadian Tax Foundation, 2010), 26:1-80, at 26:27-28.
Since this Court has to decide whether TD LLC is a resident of the United States and liable to tax therein by reason of one of the enumerated or similar grounds, it concludes that it is.\footnote{TD Securities, supra note 4, at paragraph 101.}

The court went further than simply asserting that the evidence as to purpose, combined with considerations of fairness and consistency, compelled a ruling in favour of the taxpayer: it interpreted—or strained, some would say—the terms of article IV(1) so as to achieve that purpose. Specifically, with respect to the term “liable to tax,” the court found that TD LLC had to be considered to be liable to tax in the United States by virtue of all of its income being fully and comprehensively taxed in the United States, albeit at the member level. It might be said that the liability to tax of the taxpayer here was established by association. The income of TD LLC was clearly taxable in the United States, and this was sufficient for a new interpretation of what it means for a person to be liable to tax: in some circumstances, a person can be considered to be liable to tax in a country if the person’s income is liable to tax in that country, even if in the hands of another person.\footnote{This concept is not entirely novel. Article IV(1) of the Canada-US treaty, for example, provides that an estate or trust will be considered a “resident of a Contracting State” only if, in addition to meeting the general definition of that expression, the “income derived by the estate or trust is liable to tax in that State, either in its hands or in the hands of its beneficiaries.” Thus, in the case of a trust or estate, there is a sense in which the residence of the “entity” depends on the liability to tax of its income, whether in the hands of the entity or in the hands of others. Although not addressing residence per se, article 29(7) of the Canada-France tax treaty similarly makes the eligibility of a person (certain collective investment vehicles) for treaty benefits conditional upon the income of the entity being taxable in the hands of its investors: Convention Between Canada and France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Paris on May 2, 1975, as amended by the protocols signed on January 16, 1987 and November 30, 1995.}

The further, and related, interpretive issue was whether the type of liability to tax identified by the court arose “by reason of” one of the enumerated criteria or a similar criterion. The court found that the reason that TD LLC’s income was subject to full taxation in the United States was the place of incorporation of its sole member. It asserted, without explaining, that this was a “criterion of a similar nature.” One may surmise that what made this factor a criterion of a similar nature was that it indirectly involved place of incorporation, which is an enumerated criterion. However, when place of incorporation is listed in article IV(1), it clearly refers to the place where the particular person whose residence status is in issue was incorporated: the expression used is “by reason of that person’s . . . place of incorporation.”\footnote{Article IV(1) of the Canada-US treaty defines a resident of a contracting state to be “any person that, under the laws of that State, is liable to tax therein by reason of that person’s domicile, residence, citizenship, place of management, place of incorporation or any other criterion of a similar nature [emphasis added].”}

The court found that in order for TD LLC to be a treaty resident, it sufficed that its
income was potentially subject to full taxation on the basis of the place of incorporation of a different person, Holdings II, and it was this basis for liability to tax that was held to be “of a similar nature.” Of course, article IV(1) is not accompanied by a rule, much less a yardstick, that answers the question of how similar to the listed grounds an unlisted ground for liability to tax has to be in order to be found to be of a similar nature. Nor is it obvious from the use of the word “similar” what type of similarity is required. For instance, in Crown Forest, the Supreme Court of Canada took the position that the similarity involved in article IV(1) is, in effect, a similarity of consequences: all of the enumerated criteria lead to the same result, namely, full tax liability on worldwide income.\(^89\) It is arguable that the expression “of a similar nature” is looking for inherent commonalities in the features of the enumerated criteria rather than simple similarity of consequences,\(^90\) but whether that is correct or not, the point is that the concept of similarity is complex and itself admits of varieties of meaning. In part, the ability of the court in TD Securities to interpret similarity in the way that it did is due to the fact that there are different kinds of similarities—for example, similarities as to details or as to general features. Hart spoke of how the several instances of a general term are often linked together in different ways—by analogy (for example, the “foot” of a person and the “foot” of a mountain) or by different relationships to a central element (for example, the term “healthy” being applied to a man, his morning exercise, and his complexion, with the exercise being a cause and the complexion a sign of the first characteristic).\(^91\) Something comparable was at play in the reasoning in TD Securities, where the place of incorporation of a sole member bore a similarity in detail to an enumerated category: an entity, though not the entity being tested for residence status, had been incorporated in the United States and that entity was taxable on a comprehensive basis under US law on the income of the entity whose residence status was in question. This similarity in detail (overlooking a perhaps broader general difference from the enumerated criteria) provided, it seems, just enough of a hook on which to hang the court’s finding that liability to tax arose by reason of a criterion of a similar

\(^89\) In Crown Forest, supra note 77, at paragraph 40, Iacobucci J stated, “[T]he most similar element among the enumerated criteria is that, standing alone, they would each constitute a basis on which states generally impose full tax liability on world-wide income.”

\(^90\) Admittedly, any attempt to find an inherent common feature shared by the disparate bases for liability to tax found in article IV(1) may be doomed to failure or at least oversimplification. Witness the assertion made by the lower court in Morris v. Canada (National Revenue), 2009 FC 434, at paragraph 37 (rev’d. 2009 FCA 373), that “actual physical presence” is the common element shared by all the criteria in article 4(1) of the Canada-Barbados tax treaty (Agreement Between Canada and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Bridgetown on January 22, 1980). The validity of this assertion is discussed in Matias Milet, “Deemed Residence and Treaty Residence of Trusts,” CCH International Tax nos. 54-55, December 2010, 14-19.

\(^91\) Hart, The Concept of Law, supra note 28, at 16.
nature.\footnote{There were, of course, plenty of considerations favouring the opposing finding, and to observe that the language used in article IV(1) was elastic enough to allow the court to interpret it as it did is not to say that the court was correct in not giving more weight to those other considerations.} One way of understanding the reasoning in \textit{TD Securities}, therefore, is that the judgment makes use of the open texture of one concept—the concept of similarity—to remap the boundaries of another concept, that of liability to tax.

\section*{CONCLUSION}

The assimilation of unfamiliar foreign entities to the established vocabulary of domestic law or the broadly framed provisions of a tax treaty is integral to the practice of international tax. At times, as in the UK cases \textit{Memec} and \textit{Swift}, the encounter impresses the onlooker not only with the rich variety of foreign entities but also with the capaciousness and flexibility of the terms, such as “partnership” or “transparent,” that are used to refer to the entities formed under the laws of the domestic jurisdiction—these terms being used in the United Kingdom to refer to entities as different in their legal features as English general partnerships and Scottish partnerships. The linkage among the various types of domestic partnerships or tax transparent entities being one of family resemblances (similarities and differences linking the various instances), it becomes easy enough to see why such terms have an open texture and can admit additional applications—to foreign entities that differ in many respects from entities that already are accepted as tax transparent. For Canadian courts and practitioners, one modest implication is that to the extent that the “two-step approach” is employed, this should be done with due recognition of the heterogeneity of the entities that are already accepted as being a “trust,” a “corporation,” or a “partnership,” as the case may be, for Canadian tax purposes. This means, for instance, that the comparison of the foreign entity to, say, a domestic corporation would accept both limited and unlimited liability companies as domestic analogues.

In sidestepping the entity classification question to different degrees, both \textit{Swift} and \textit{TD Securities} provide a reminder that, particularly in a treaty context, there are other ways of thinking through problems involving the income derived by or through a hybrid entity than by first assimilating the foreign entity to a familiar domestic category from which Canadian tax consequences are to be mechanically derived. The resources for an alternative approach may lie no farther away than the sparse yet broad language of the provisions of Canada’s tax treaties. Recognizing that the general terms in which those provisions are framed (terms like “liable to tax” or “similar nature”) may accommodate applications that are linked together in a variety of ways may make the broadening of concepts in cases involving unfamiliar legal constructs easier to understand and perhaps accept—particularly where the objective is a fair allocation of taxing jurisdiction between contracting states.