Crown Forest Industries: The OECD Model Tax Convention as an Interpretive Tool for Canada's Tax Conventions

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PRÉCIS

Cet article traite de la décision de la Cour suprême du Canada dans *The Queen v. Crown Forest Industries Ltd.* en ce qui a trait à l'utilisation du Modèle de convention fiscale de l'OCDE dans l'interprétation des convention fiscales au Canada. Après un survol des décisions antérieures dans cette affaire et des arguments présentés devant la Cour suprême, l'auteur analyse le raisonnement de la Cour quant à la question à savoir si l'on doit faire référence au Modèle de convention fiscale de l'OCDE en vertu de l'Article 31 ou de l'Article 32 de la Convention de Viennes. L'auteur conclut qu'à la lumière de la décision de la Cour suprême du Canada dans cette affaire, le Modèle de convention fiscale de l'OCDE et ses commentaires devraient être pris en ligne de compte lors de toute décision judiciaire subséquente mettant en question l'interprétation d'une des conventions fiscales conclues par le Canada.

ABSTRACT

This article reviews the Supreme Court of Canada decision in *The Queen v. Crown Forest Industries Ltd.* as it pertains to the use of the OECD model tax convention in the interpretation of tax treaties in Canada. After reviewing the decisions of the lower courts and the arguments presented before the Supreme Court, the author analyzes the Supreme Court's reasoning, particularly with respect to the question whether the OECD model tax convention should fall within the ambit of article 31 or article 32 of the Vienna convention. The author concludes that, in the light of the Supreme Court of Canada decision, the OECD model tax convention and commentary should be taken into consideration in all future court decisions involving the interpretation of Canada's income tax treaties.

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INTRODUCTION

On March 2, 1995, the Supreme Court of Canada heard the appeal in one of the most important cases to date in the field of international tax in Canada and the interpretation of tax treaties. The case is *The Queen v. Crown Forest Industries Ltd.* Both the Federal Court—Trial Division[1] and the Federal Court of Appeal[2] had previously decided the case in the taxpayer's favour. With Revenue Canada's appeal of the second decision, the Supreme Court was given the opportunity to determine the importance of the OECD model tax convention,[3] its place in the interpretation of Canada's tax treaties, and the proper interaction between this model and Canada's tax laws and conventions.

BACKGROUND

Federal Court—Trial Division Decision

The facts of the case[4] can be summarized as follows. Fletcher Challenge Limited of New Zealand was the parent company of Crown Forest Industries Ltd. ("Crown Forest") of Canada and of Norsk Pacific Steamship Company Limited ("Norsk") of the Bahamas. Norsk's only office and place of business was in the United States. Norsk's Canadian operations were conducted through one of its subsidiaries located in Vancouver. During the years under appeal, Crown Forest rented barges from Norsk, for which it paid rent to Norsk. The barges were registered in Canada and operated by Crown Forest to transport wood chips to Canadian pulp mills, to transport chips and finished goods from Canada to the United States, and occasionally to carry wood chips to Canada on the return voyage.

For each of the years under appeal, the only income tax returns filed by Norsk with the US Internal Revenue Service (IRS) were on form 1120F, "Income Tax Return of a Foreign Corporation." In each of these returns, Norsk had claimed the benefit of an exemption from US federal income tax pursuant to section 883 of the US Internal Revenue Code[5] because its income was derived from the operation of ships and Norsk was organized in the Bahamas, which grants an equivalent exemption to US corporations. Because of this exemption, Norsk did not pay tax in the United States on the rental payments from Crown Forest for the years in question. The only country in which Norsk had filed tax returns for the years in question was the United States.

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[1] *Crown Forest Industries Limited v. The Queen*, 92 DTC 6305 (FCTD).

[2] *The Queen v. Crown Forest Industries Limited*, 94 DTC 6107 (FCA).

[3] For the purposes of the *Crown Forest* case, the model convention referred to was Organisation for Economic Co-operation and Development, *Model Double Taxation Convention on Income and on Capital* (Paris: OECD, 1977) (herein referred to as "the OECD model tax convention" or "the OECD model"). The model convention was revised and published in a looseleaf format in 1992: Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf).

[4] Supra footnote 1, at 6306-7.

[5] Internal Revenue Code of 1986, as amended.

Both the taxpayer and Revenue Canada agreed that the payments from Crown Forest to Norsk constituted a "rent, royalty or similar payment," which would be subject to the 25 percent withholding tax under paragraph 212(1)(d) of the Income Tax Act.[6] However, Crown Forest contended that the provisions of article XII(2) of the Canada-US tax convention[7] relieved it of this 25 percent withholding requirement and replaced it with the 10 percent withholding rate. The question to be resolved by the court was whether Norsk was a resident of the United States for the purposes of the convention.

The relevant provision of the Canada-US convention is article IV(1), which reads, in part, as follows:

> For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature.

The court stated that the question was one of determining whether Norsk was liable to tax in the United States by reason of the criteria listed in article IV(1) or any other criterion of a similar nature. The court also stated that this determination was a matter of US law and regarded it as a question of fact to be proven through the use of expert testimony. After reviewing the evidence and arguments, Muldoon J noted that both sides agreed that in the United States, a foreign corporation, such as Norsk, is liable to income tax on the same basis as a domestic corporation on income effectively connected with a trade or business that the corporation carries on in the United States. He then found as a fact that "[i]n the case of Norsk, its connection is carrying on its business from its place of management *situated in* the U.S.A. and in generating income effectively connected with its business."[8]

Muldoon J emphasized the proper interpretation to be given to the expression "by reason of" in article IV(1). He found that expression to bear a liberal interpretation, which enabled the court to include criteria that were not explicitly listed in article IV(1) but were indirectly linked to those listed criteria. The court accordingly found that Norsk's income was effectively connected with a business actively conducted in the United States because its place of management was located in that country.[9] In this respect, Muldoon J remarked that if the parties to the convention had intended to exclude corporations like Norsk from the status of resident of

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[6] RSC 1985, c. 1 (5th Supp.), as amended.

[7] 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, 1984 and March 28, 1984 (herein referred to as "the Canada-US convention" or "the convention").

[8] Supra footnote 1, at 6309.

[9] Ibid., at 6309-11.

a contracting state and from the related treaty benefits, they could have simply written in the convention that this was what they meant.

The Federal Court—Trial Division hence found for Crown Forest.

Federal Court of Appeal Decision

The Federal Court of Appeal, in a split decision, also ruled in Crown Forest's favour but added a new element to the majority's reasons: to reach its conclusion, it relied, in part, on the difference between the wording of the OECD model tax convention and article IV of the Canada-US convention.

Revenue Canada's appeal of the Federal Court—Trial Division's decision was based on two grounds, summarized as follows:

> It is suggested that there are two important errors in the reasoning of the Trial Judge. The first alleged error relates to the findings of fact. The appellant submits that Norsk's liability for U.S. tax arises because the trade or business which it conducts is effectively connected with the U.S. and not because its place of management is located in the U.S. The second alleged error concerns the application of the Convention to the facts. In particular, the issue is whether Norsk is liable to tax in the U.S. by reason of its "domicile, residence, place of management, place of incorporation or any criterion of a similar nature."[10]

The majority's judgment, rendered by Heald J (McDonald J concurring), dismissed the first ground of appeal as a finding of fact that was reasonably open to the trial judge and without the presence of any palpable or overriding error in this finding.

On the second ground of the appeal, whether the factual finding that Norsk's place of management was a prime factor in its liability to tax in the United States was sufficient to bring Norsk within article IV(1) of the convention, the court, in finding for Crown Forest, felt compelled to review Revenue Canada's four submissions on this issue. The first of these submissions and the court's reasons were as follows:

> (1) [S]ince foreign corporations are not generally liable to tax in the U.S. on the basis of their place of management, Norsk cannot be found liable on this basis.[11]

The court found that the question was not whether, as a general rule, the United States imposes tax by reason of the foreign corporation's place of management, but whether, on the facts before the court, Norsk was liable to pay tax by reason of its place of management.

Revenue Canada's second submission and the court's response were as follows:

> (2) [T]he inclusion of the phrase "or a criterion of a similar nature" in Article IV.1 indicates a common basis for liability under that Article,

[10] Supra footnote 2, at 6111.

[11] Ibid., at 6112.

> specifically, liability to tax on a world-wide basis, and Norsk is not liable on this basis.[12]

Revenue Canada's argument was that the common element in the criteria enunciated in article IV(1) was that "each, of itself and standing alone, would form a basis for taxation, that each was readily and objectively identifiable and that each could be related to a specific location."[13] Therefore, a criterion of a similar nature had to encompass the same common elements, and one of these elements was the liability to tax on all world-wide income.

The court rejected this argument but, in doing so, it referred directly to the OECD model tax convention. In an obiter dictum, the court noted that the OECD model tax convention contained an important qualification found in the second sentence of article 4(1), which read as follows: "But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein." The court stated that, without evidence of a contrary intent, it was reasonable to conclude that the drafters of the Canada-US convention were aware of the second sentence of article 4(1) of the OECD model and that the omission of that sentence from article IV of the Canada-US convention was intentional. The court concluded that the omission indicated that the drafters did not intend to make liability to tax on a worldwide basis a condition for residency status under the Canada-US convention.[14]

Hence, the Federal Court of Appeal confirmed the use of the OECD model tax convention in interpreting Canada's various tax treaties.[15] It is noteworthy, however, that the court based this interpretation, not on the presence of the same wording in both the OECD model and the Canada-US convention, but on the conspicuous absence from the latter convention of a sentence found in the OECD model. The court also considered it important that there be evidence of a contrary intent on the drafters' part in order to depart from the interpretation found in the OECD model where there were differences between the OECD model and the Canada-US convention. In other words, the court seemed to infer that where there were differences in wording between the OECD model and the Canada-US convention, but no statement of contrary intent, even though the differences were intentional, they did not change the meaning of the provision.

The majority of the court also dismissed Revenue Canada's third and fourth submissions.[16]

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[12] Ibid.

[13] Ibid.

[14] Ibid., at 6113.

[15] The use of the OECD model tax convention had previously been recognized by the Tax Court of Canada in *Hinkley v. MNR*, 91 DTC 1336.

[16] "(3) [T]he finding that Norsk is liable to tax because its income is effectively connected with the conduct of its trade or business, is a criterion of a similar nature, and, as such, is tantamount to an amendment to the Convention and (4) the interpretation given to Article IV.1 by the Trial Judge would lead to anomalous results." Supra footnote 2, at 6112.

Décary J, in a well-crafted dissent, would have allowed the appeal. After reviewing the trial judge's findings and identifying the flaws that he found in the judge's reasoning, he stated that to consider that tax liability caused by the conduct of a business effectively connected with the United States was similar in nature to tax liability caused by the place of management amounted to an amendment to the convention.[17]

When the Federal Court of Appeal rendered its decision, although the decision itself was criticized, the use of the OECD model tax convention in this case was hailed as a breakthrough in the interpretation of tax treaties in Canada.[18]

THE ARGUMENTS BEFORE THE SUPREME COURT OF CANADA

When the *Crown Forest* case came before the Supreme Court, a new player had appeared on the scene: the United States joined the debate as intervener in support of Revenue Canada's position.

Although at the Federal Court of Appeal the reference to the OECD model tax convention had emerged in an obiter dictum, at the Supreme Court the OECD model became the focal point of the debate. All parties spent most of their time discussing its application in the context of the Canada-US convention.

Revenue Canada began by recognizing the one point on which all the parties agreed: article IV of the Canada-US convention was based on article 4 of the OECD model. Revenue Canada then argued that, although there were differences between the two, the Canada-US convention had retained the concepts behind the OECD provision, particularly the criteria used to tax income on a comprehensive or worldwide basis. The Canada-US convention differed from the OECD model on two points: by adding a new criterion to the list—"place of incorporation"—and by omitting the second sentence of article 4(1) in the OECD model.

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[17] Ibid., at 6115.

[18] See Richard G. Tremblay, "Crown Forest—Tax Treaty Interpretation Bonanza" (February 1994), 4 *Canadian Current Tax* C41-43, at C43: "However, the majority's reference to the missing sentence in the Convention as compared to the OECD Model is a very compelling technical argument in favour of the decision reached. Unless some convincing rationale can be offered for this difference, the majority finding will likely stand. It seems unlikely that the Supreme Court would entertain an appeal or overturn a decision based solely on the argument that United States tax liability did not arise by reason only of the place of management being in the United States. This clause may have been omitted from the Canadian and United States treaty models because they felt it inappropriate to have such a clause in treaties with countries that tax on a territorial basis. They may also have felt that the wording of the first sentence was sufficient to convey the extensive link required between the entity and the residence country. In particular, they may have felt that the expression 'place of management' would be interpreted more along the lines of 'central management and control.' It appears likely that a legislative fix or Protocol amendment will be required to correct the situation."

Regarding the first difference, Revenue Canada argued that the inclusion of place of incorporation in the criteria was necessary because the United States imposes full tax liability on the basis of incorporation in the United States. Counsel also argued that the rest of the criteria did not have any special relevance to either of the parties to the convention. Indeed, the "domicile" criterion was of no importance to the Canadian or US tax authorities in respect of income or capital taxes. Therefore, there was no necessity for the trial judge to assign a meaning to every word and concept in article IV(1) of the convention. The proper interpretation should simply have led to resolution of the question whether Norsk was taxable in the United States on all of its worldwide income.

Revenue Canada maintained that article IV(1) clearly embodied the concept of full tax liability. The court, however, raised the reasonable question why the drafters of the convention had not said that, if that was what they meant.[19]

Perhaps because of the lack of cases on the topic, counsel for Revenue Canada and for the United States relied heavily on articles by various authors to buttress their arguments. The court noted that all the commentators quoted seemed to agree with Revenue Canada's position; however, again the question arose why the drafters had not made their meaning clear by simply defining the term "liable to tax" in the manner suggested by these analysts.[20]

Regarding the second point of difference in the Canada-US convention, Revenue Canada argued that the second sentence of article 4(1) had been omitted because it was not necessary in the Canada-US context.

Revenue Canada's argument reflects a curious paradox. On the one hand, article IV(1) was drafted, in part, to remove a sentence that did not mean anything; but on the other hand, supposedly meaningless expressions (such as "place of management" and "domicile") were intentionally retained. If this position is correct, taxpayers could be left to wonder when words may be used *even though* the tax administrations regard them as meaningless and when other words may be deleted *because* they are meaningless.[21]

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[19] *Her Majesty the Queen and Crown Forest Industries Ltd.*, transcription of tapes, Thursday, March 2, 1995, 2:00 PM, court file no. 23940, at 21-22. Although Mr. Justice Sopinka's approach may seem appealing, one might speculate that the OECD itself has chosen not to use the expression "full tax liability" because some of the member countries do not impose tax, as Canada and the United States do, on worldwide income. The OECD has preferred to use the concept of comprehensive liability to tax as reflected in the wording of article 4(1) of the OECD model tax convention.

[20] Ibid., at 26-27. See also the comments in footnote 19, supra.

[21] I recognize that a historical argument may be presented to explain why such expressions as "domicile" and "place of management" were left in the convention: these terms had been used in treaties negotiated between Canada and other countries before the negotiation of the Canada-US convention, and before the drafting of the OECD model tax

(The footnote is continued on the next page.)

More important, the paragraph in question was amended to delete a sentence that would have clearly maintained the concepts found in article 4(1) of the OECD model tax convention; yet, it was argued, article IV(1) of the Canada-US convention retained the meaning of its OECD counterpart. Hence, the deletion of the second sentence either would have no bearing on the meaning of the paragraph or would not change its original meaning. If such an interpretation were upheld by the courts, what magnitude must a departure from the OECD model tax convention have, in the context of any tax treaty, in order to shed the concepts found in the model convention? Perhaps a departure from the meaning of the OECD model would have to be clearly specified by the treaty partners, either within the treaty itself or in an accompanying instrument (such as, in the case of the Canada-US convention, the technical explanation).

Counsel for Crown Forest contended that Revenue Canada and the US intervener were attributing an unstated and unlegislated meaning to article IV(1) of the Canada-US convention. All that was required, he said, was to read the actual words of the provision:

> The Treaty says that if you are liable to tax in the United States because of your place of management, you are resident in the United States. We say within the words of the Treaty, we fit. We are liable to tax in the United States, the nexus that ties us to the United States is our place of management and that may not be what the signatories of the Treaty now want but as the Treaty reads, we believe that Norsk fits within the definition.[22]

This was an invitation to adopt a literal interpretation of the convention. Unfortunately, as it subsequently emerged in the court's judgment, such a reading of article IV(1) led in the opposite direction to that suggested by counsel for the defence.

Since the court appeared to be swayed by the apparent consensus among various commentators in support of Revenue Canada's position, counsel for Crown Forest suggested that the opinion of experts was of limited value. The convention was meant to be interpreted by the taxpayers to whom it applied, and the words used in the convention were to be read as they would be understood by taxpayers.[23]

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[21] Continued . . .
convention. Thus, the negotiators and the drafters felt comfortable with these expressions and saw no need to delete them. The treaty negotiators also saw no need to incorporate the second sentence from article 4(1) of the OECD model tax convention because this concept, meant to apply to diplomats, had no application between these two states.

[22] Supra footnote 19, at 54.

[23] Ibid., at 60. The following exchange took place:

> Mr. Warren J.A. Mitchell: . . . There is a Convention called the I.F.A. Convention where all the international tax lawyers gather and, given the right mixture of champagne and self-delusion you can believe you are in the real world. They all agree with one another. I have no quarrel with that. But the folks at Walnut Creek do not go with that crowd much, and it is the folks at Walnut Creek who are reading this Convention and saying, "Does it apply to me?"
>
> Sopinka J.: Maybe we can learn a lesson as to how to achieve such unanimity.

Counsel for Crown Forest did not address the paradox noted earlier regarding the retention of certain apparently meaningless expressions in article IV(1) and the omission of an entire sentence included in the OECD model. In other words, no rationale was offered for the argument that an omission indicated that a particular concept was dropped from the convention while the inclusion of certain words did not necessarily convey the meaning intended in the OECD model.

THE SUPREME COURT'S DECISION

In a unanimous judgment written by Iacobucci J, the Supreme Court allowed Revenue Canada's appeal. After reviewing the lower courts' decisions, the court introduced its own analysis in the following manner:

> In interpreting a treaty, the paramount goal is to find the meaning of the words in question. This process involves looking to the language used and the intentions of the parties. Both upon the plain language reading of Art. IV and through an interpretation of the goals and purposes of the *Canada-United States Income Tax Convention (1980)*, I reach the same destination: to allow the appeal.[24]

Thus, the court separated its analysis into two parts: the first part, entitled "The Plain Language," reviews the meaning of the words used in article IV(1) of the Canada-US convention; and the second part, entitled "What was the Intention of the Drafters of the Convention?" addresses the issue of the intent of the provision, and the use and application of the OECD model tax convention and commentary.

The Plain Language

In the first part of the analysis, the court generally adopted and endorsed Décary J's dissent in the Federal Court of Appeal decision. Iacobucci J stressed the need to look at the expression "by reason of" and stated that "[t]his connotes the existence of some sort of causal connection or, in the least, some relationship of proximity."[25] The court found that no such connection existed between Norsk's place of management and the basis of Norsk's tax liability in the United States. After reviewing the basis of taxation of foreign corporations under US law, the court found as follows:

> The place of management is only one factor in the determination of whether the first condition [that the foreign corporation must be engaged in trade or business in the United States] mentioned above is met. To this end, ascertaining that Norsk is a resident under the Convention because its place of management is in the United States erroneously amounts to elevating *a factor* used in determining its tax liability into *the actual grounds* for that tax liability. Place of management is one step removed from the true and immediate basis for tax liability.[26]

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[24] *The Queen v. Crown Forest Industries Limited et al.*, 95 DTC 5389, at 5393 (SCC).

[25] Ibid.

[26] Ibid., at 5394.

After reviewing the criteria enunciated in article IV(1), the court concluded:

> I agree with the appellant that the 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. . . . In this respect, the criteria for determining residence in Art. IV.1 involve more than simply being liable to taxation on some portion of income (source liability); they entail being subject to as comprehensive a tax liability as is imposed by a state. In the United States and Canada, such comprehensive taxation is taxation on world-wide income. However, tax liability for the income effectively connected to a business engaged in the U.S. [sic], pursuant to s. 882 of the *Internal Revenue Code*, amounts simply to source liability. Consequently, the "engaged in a business in the U.S." criterion is not of a similar nature to the enumerated grounds since it is but a basis for source taxation.[27]

The court also stated that the trial judge's "findings" on the proper interpretation of the convention were not factual findings but a conclusion as to law or mixed law and fact; therefore, these conclusions were reviewable by an appellate court.

The Drafters' Intention

Turning to the second part of the analysis, the court confirmed the conclusion reached in the first part of its analysis by considering the intention of the drafters of the Canada-US convention. The court first stated that the intended beneficiaries of the convention are Canadians working in the United States (or US citizens working in Canada) and Canadian companies operating in the United States (or US companies operating in Canada), and that the general objectives of the convention are the reduction or elimination of double taxation and the prevention of tax avoidance and evasion. The court found that there was no possibility of double taxation in Norsk's case because, by virtue of the exemption in section 883(a) of the Internal Revenue Code, the United States has declined to tax Norsk's revenue. The court went on to state:

> Allowing Norsk to benefit from the Convention in this case would actually lead to the avoidance of tax on the rental income because the liability for tax asserted by the Canadian authorities would be reduced notwithstanding that the United States chooses not to impose any tax thereon or does not even have the jurisdiction therefor.
>
> The goal of the Convention is not to permit companies incorporated in a third party country (the Bahamas) to benefit from a reduced tax liability on source income merely by virtue of dealing with a Canadian company through an office situated in the United States. As far as I can see it, if there were any tax convention that Norsk would be able to benefit from, it is that concluded between the U.S. and the Bahamas. . . . It seems to me that both Norsk and the respondent are seeking to minimize their tax liability by picking and choosing the international tax regimes most immediately beneficial

[27] Ibid., at 5395.

> to them. Although there is nothing improper with such behaviour, *I certainly believe that it is not to be encouraged or promoted by judicial interpretation of existing agreements* [emphasis added].[28]

Thus, in arriving at the conclusion that it was not the purpose of the convention to benefit taxpayers in situations such as the one at hand, the Supreme Court perhaps implicitly created a presumption in the interpretation of tax treaties against treaty shopping and other kinds of international schemes to reduce tax liability.

The court then turned its attention to the use of "extrinsic materials"—other international tax conventions and general models—to assist in the interpretation of a convention. The court first observed:

> Clearly, the purpose of the Convention has significant relevance to how its provisions are to be interpreted. I agree with the intervener Government of the United States' submission that, in ascertaining these goals and intentions, a court may refer to extrinsic materials which form part of the legal context (these include accepted model conventions and official commentaries thereon) without the need first to find an ambiguity before turning to such materials.[29]

The court later referred to articles 31 and 32 of the Vienna Convention on the Law of Treaties,[30] stating that they allow reference to such extrinsic materials to assist in the interpretation of international documents.[31] These statements laid the foundation for the use of the OECD model tax convention as a reference in the case before the court.

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[28] Supra footnote 24, at 5397.

[29] Ibid., at 5396.

[30] UN Doc. A/Conf. 39/27, opened for signature at Vienna on May 23, 1969 (herein referred to as "the Vienna convention").

[31] Articles 31 and 32 of the Vienna convention read as follows:

ARTICLE 31

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its provisions;

(c) any relevant rules of international law applicable in the relations between the parties.

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The Role of the OECD Model in Interpretation

In referring to both articles 31 and 32 of the Vienna convention, the court did not indicate clearly what status it accorded the OECD model tax convention as an aid to interpretation. Was it to be considered a primary reference under article 31, or was it rather a supplementary means of interpretation under article 32? Perhaps the court itself was uncertain about the proper classification of the OECD model tax convention within the ambit of articles 31 and 32. Otherwise, having stated that model conventions fell within the "legal context," the court could have relied strictly on article 31. Alternatively, since article 32 permits reference to supplementary means of interpretation in order to confirm the meaning resulting from the application of article 31 (hence, without the need to first find ambiguity), the court could have relied on that provision instead. The court's reference to both articles seems to leave open the question of the proper role to be accorded the OECD model tax convention in the interpretation of Canada's tax treaties.

A further complication arises from the manner in which the court laid the groundwork for its reference to the OECD model tax convention. As indicated above, the court began by asserting, in agreement with the position of the intervener, that the OECD model tax convention forms part of the "legal context" of the Canada-US convention. The court then affirmed that articles 31 and 32 of the Vienna convention permit reference to such extrinsic materials for the purposes of interpretation. While the latter statement clearly serves to lay the foundation for the introduction of the OECD model as an aid to interpretation, the former statement may be difficult to reconcile with it. The United States could not rely on the Vienna convention, because the United States has not ratified that convention. Indeed, there was no mention of it in the US factum or in the US counsel's arguments before the court. It may be argued that the Vienna convention represents a codification of existing customary international law and, as such, could have been referred to and relied upon by the United States. However, it remains unclear whether the United States officially recognizes as customary international law the principles embodied in articles 31 and 32 of the Vienna convention.[32]

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[31] Continued . . .

4. A special meaning shall be given to a term if it is established that the parties so intended.

ARTICLE 32

Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.

[32] David Ward, "Introduction to the Law of Treaties," in Davies, Ward & Beck, *Ward's Tax Treaties 1994-1995* (Scarborough, Ont.: Carswell, 1995), 1-55, at 19, seems to indicate

(The footnote is continued on the next page.)

When agreeing with the intervener that the OECD model tax convention fell within the "legal context" of the convention and subsequently referring to the provisions of the Vienna convention, the court essentially quoted, almost verbatim, from the intervener's and Revenue Canada's factums respectively. The paradox in the court's use of these two statements is that they are based on quite different reasoning. The intervener used the term "legal context" in putting forward an approach that a court could follow, without relying on the Vienna convention, to use the OECD model tax convention as a tool for interpretation of tax treaties.[33] In contrast, Revenue Canada relied specifically on the Vienna convention as the indication that reference could be made to the OECD model tax convention—although, as in the court's judgment, Revenue Canada did not specify which of articles 31 and 32 applied to this situation but simply referred to both.

The international fiscal community is far from unanimous as regards the proper treatment and place of the OECD model tax convention and its commentary as interpretive tools for specific tax treaties.[34] Furthermore, the authors who have covered Canada's position on this topic report that there is no clear guidance to date.[35]

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[32] Continued . . .
that the United States would tend to apply the terms of the provisions of the Vienna convention. However, the American Law Institute reported in 1992 that the "*Restatement Third* takes the view that the status of these principles as customary international law is not clear and therefore that, until the Vienna convention comes into force in the United States, the principles of *Restatement Third* § 325 (which follows Article 31, paragraphs 1 and 3 of the Vienna Convention) do not strictly govern U.S. interpretation of treaties." American Law Institute, *International Aspects of United States Income Taxation II: Proposals on United States Income Tax Treaties*, Hugh J. Ault and David R. Tillinghast, reporters (Philadelphia: American Law Institute, 1992), 32.

[33] It is interesting to note, however, that in support of the position that a court may refer to extrinsic materials (such as the OECD model tax convention) that form part of the "legal context," the first authority cited in the intervener's factum actually refers to context pursuant to article 31 of the Vienna convention: Ian Brownlie, *Principles of Public International Law*, 4th ed. (Oxford: Clarendon Press, 1990), 629.

[34] Some authors have touched on this topic before. If any common thread can be found, it is that there is no worldwide consensus on the proper place of the OECD model tax convention in the interpretation of tax treaties in the light of articles 31 and 32 of the Vienna convention. See the International Fiscal Association, *Cahiers de droit fiscal international*, volume 78a, *Interpretation of Double Taxation Conventions* (Deventer, the Netherlands: Kluwer, 1993)—specifically, Klaus Vogel and Rainer Prokish, "General Report," 55-85, at 64-66; David H. Bloom, "Australia," 179-92, at 189-90; Giovanni B. Galli and Anna Miraulo, "Italy," 385-402, at 396-99; John F. Avery Jones, "United Kingdom," 597-612, at 610-12; and Stanley I. Katz, "United States," 615-54, at 637-38. See also Klaus Vogel, *Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation of Income and Capital* (Deventer, the Netherlands: Kluwer, 1991), 34.

[35] Jean-Marc Déry and David A. Ward, "Canada," in *Interpretation of Double Taxation Conventions*, supra footnote 34, 259-89, at 274-75; Ward, supra footnote 32, at 36; and Jacques Sasseville, "Interpretation of Double Taxation Conventions in Canada: An Update" (August-September 1994), 48 *Bulletin for International Fiscal Documentation* 374-79, at 379.

Three alternatives are possible, in the light of the court's statements, as the proper basis for reference to the OECD model tax convention in the interpretation of Canada's tax treaties:

1) The "legal context" is a concept, independent of the Vienna convention, on which the Canadian courts can rely to refer to extrinsic materials when interpreting Canada's tax treaties. Accordingly, there is no need to rely on the provisions of the Vienna convention.

2) The OECD model tax convention is part of the context of Canada's tax treaties within the meaning of article 31 of the Vienna convention.

3) The OECD model tax convention is a supplementary means of interpretation within the meaning of article 32 of the Vienna convention.

In my view, the first alternative is not the proper interpretation of the court's decision in this case. The court's reference to the "legal context" arose from the intervener's assertion that the OECD model formed part of that context and therefore could be used as an aid to interpretation. As noted above, the intervener could not invoke the Vienna convention because it has not been ratified by the United States. Accordingly, in referring to the "legal context," the court simply recognized it as an acceptable alternative where the Vienna convention was not applicable.[36] Although the two approaches, that of the legal context and the one found in articles 31 and 32 of the Vienna convention, are aimed at the same purpose of providing the basis for reference to the OECD model tax convention, they may not be used interchangeably. The provisions of the Vienna convention apply in a Canadian setting,[37] while the concept of "legal context" may be used when a court is required to address the interpretation of an international treaty in countries that have not ratified the Vienna convention.

Since the first alternative is not correct, the only remaining problem is to decide between article 31 and article 32 of the Vienna convention as the proper basis in the light of the court's words.

On the one hand, it might be argued that the OECD model tax convention would fall under the heading "Supplementary means of interpretation" of article 32.[38] Although the word "comprise" used in article 31(2) imports a meaning of inclusion rather than an exhaustive definition, the

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[36] For discussion of the application of the Vienna convention in Canada and elsewhere, see Ward, supra footnote 32.

[37] See, for instance, *Thomson v. Thomson*, [1994] 3 SCR 551.

[38] This position is supported by, among others, Bloom, supra footnote 34, at 189, and Michael Edwardes-Ker, *Tax Treaty Interpretation* (London: In-Depth Publishing) (looseleaf), paragraph 15.04. Edwardes-Ker specifically addresses the Supreme Court of Canada decision in *Crown Forest* and supports his position by noting that the reference to "legal context" was made before the court referred to the Vienna convention; thus, he suggests, it must be assumed that extrinsic materials, such as the OECD model tax convention, that form part of the legal context can be referred to without the need to refer to the Vienna convention. Edwardes-Ker finds additional support in the fact that the court rejected the

(The footnote is continued on the next page.)

elements listed in that paragraph are linked by a common thread: they were "made . . . in connexion with the conclusion of the treaty." While the technical explanation could be considered an instrument that was made in connection with the conclusion of the Canada-US convention, the OECD model tax convention was made separately from and prior to the convention and involved many more parties. Although the words "in connexion" may be liberally construed to include materials of a general nature, such as the OECD model, it could be argued that these materials must reflect a closer link in both time[39] and specificity to the convention, such as the technical explanation or the subsequent protocols, and that these materials must be prepared by the parties to the convention. While Canada and the United States are members of the OECD, other countries also assisted in the development of the OECD model, and the aim of the OECD model was not to specifically assist the drafting of the Canada-US convention. Similarly, article 31(3) refers to subsequent agreements and practices, but the OECD model tax convention chronologically precedes the Canada-US convention.[40] Therefore, and in the light of the introductory

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[38] Continued . . .
need to find ambiguity before extrinsic materials could be considered. In his words, "[s]uch rejection implies that Article 32 of the Vienna Convention (which *only permits recourse to supplementary means of interpretation if a meaning is ambiguous* . . .) imposes no constraints at a domestic level [emphasis added]." However, article 32 of the Vienna convention allows reference to supplementary means of interpretation not only to resolve an ambiguity, but also to confirm an interpretation based on article 31. Further, if the Supreme Court of Canada had no need to refer to the Vienna convention after simply stating that the OECD model tax convention was part of the "legal context" of the convention, it should not have mentioned the Vienna convention. However, the Vienna convention was not only mentioned, but also relied upon as permitting reference to materials such as the OECD model tax convention. As I have argued above, the use of the concept of "legal context" was necessary for the intervener only because the United States has not ratified the Vienna convention. In my view, it would be surprising if, by agreeing with the intervener, the court intended to import the US approach to the interpretation of international conventions in Canada to the exclusion of or in preference to the Vienna convention.

[39] Ian Sinclair, *The Vienna Convention on the Law of Treaties*, 2d ed. (Manchester, UK: Manchester University Press, 1984), 129, states that, to form part of the context of a treaty, the instrument in question must be drawn up when the treaty is concluded. This statement, however, does not specifically address the proper treatment of the OECD model tax convention, nor is it further supported. In my opinion, the OECD model tax convention differs sufficiently from other instruments drawn up by contracting states in respect of international treaties that one must look beyond the mere circle of instruments drawn up when the treaty is concluded. The main difference is that the OECD model tax convention constitutes an agreement in advance on the proper interpretation to be given to international tax treaties that follow the model. Hence, it could be argued that the parties to the OECD model have, in effect, agreed to be bound by the interpretation found in the commentary unless a reservation or an observation has been filed with the OECD or unless the contracting states specifically state at the conclusion of the treaty that they do not intend to follow the OECD model.

[40] It might be argued that, since work on the OECD model tax convention is ongoing, it can be viewed as "subsequent practice"; but it also might be argued, for the purposes of article 31(3) of the Vienna convention, that the reference to subsequent practice is only indicative of general principles and does not specifically apply to the convention (hence, it still would not fall under article 31 of the Vienna convention).

paragraph of article 32, it could be said that, ambiguity and absurdity aside,[41] the OECD model tax convention should be used only to confirm the interpretation arrived at using the means outlined in article 31 of the Vienna convention—hence, the need for the two-part analysis by the court.

One might also wonder whether the OECD model tax convention could be introduced to show ambiguity in meaning and to open the door to the use of supplementary means of interpretation in accordance with article 32. This approach should be resisted. The use of supplementary means of interpretation should be allowed only to confirm the meaning found in accordance with article 31, or to determine the meaning if ambiguity or absurdity is found when the provisions in question are interpreted in accordance with article 31. The supplementary means of interpretation themselves should not form part of the "initial" interpretation of the provisions in conformity with article 31. To rule otherwise would be to invite circular reasoning in contradiction of the provisions of articles 31 and 32.

On the other hand, it could also be argued that the OECD model tax convention is an agreement among the member countries reflecting a consensus on the proper wording and meaning of the various provisions, and intended for use in all future negotiations of tax treaties between these member countries. Hence, it could be viewed as an agreement between, among others, Canada and the United States that relates to the Canada-US convention and was made in connection with the conclusion of that convention. The link between the OECD model tax convention and the Canada-US convention (or any of Canada's other tax treaties based on the OECD model) is specific enough to make it part of the context within the ambit of article 31 because, as agreed by the parties in this case, the OECD model served as the basis for the negotiation of the Canada-US convention.

In my view, the OECD model tax convention arguably falls within the "context"[42] of an international treaty within the meaning of this term in article 31. Although the term "legal context" is not found in either article 31 or 32, the use of this expression by the Supreme Court in a sentence immediately following another sentence that restates the importance of the purpose of the treaty subject to interpretation, may reasonably lead to an inference that the court was thinking in terms of the context referred to in article 31, rather than referring to article 32.

The OECD model tax convention and commentary are not an expression of one contracting state's unilateral interpretation of tax conventions

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[41] One might have argued that, in any event, the meaning of "residence" in article IV was ambiguous in the light of the "missing second sentence" and the notion of domicile, which really had no application between Canada and the United States. Thus, the court could also have had recourse to the OECD model tax convention by arguing that the analysis pursuant to article 31 of the Vienna convention led to an ambiguity in meaning.

[42] Vogel and Prokish, supra footnote 34, at 65, suggest that, in certain circumstances, the OECD model tax convention and commentary may be primarily part of the context and not simply "preliminary materials." See also Vogel, supra footnote 34, at 34.

in general (such as the United States' technical explanations, which accompany most of the US tax treaties, when these technical explanations are not expressly accepted by the other treaty partners). The OECD model and commentary are the result of a consensus between member countries, represented by their respective ambassadors to the OECD, not only as to the proper model agreement relating to income taxes and the avoidance of double taxation, but also as to the proper interpretation of the provisions of such a model. Hence, in the absence of reservations and observations, the relevant provisions and commentary of the OECD model tax convention should be regarded as part of the context of any tax treaty within the meaning of article 31. The reference to article 32 in the court's reasons could therefore be seen as having been made in passing and not as the basis to support the use of the OECD model tax convention as an interpretive tool in this case.

The proposition that the OECD model tax convention forms part of the context of an international convention within the ambit of article 31 of the Vienna convention has far-reaching implications. These, however, can be summed up in the following manner: in the interpretation of Canada's tax treaties, the Canadian courts should always refer to the version of the OECD model tax convention in place at the time the tax treaty in question was signed as part of the context of that treaty.

This means that the question whether the other treaty partner is a member of the OECD may be of little relevance in the interpretation of tax treaties in Canada. It may become relevant where the other treaty partner has publicly stated views that differ from those of the OECD.[43] If this other treaty partner were an OECD member, these views would presumably find their way into the observations and reservations to the OECD model tax convention and commentary. The introduction to the OECD model tax convention clearly states that this model is used, not only in tax treaties negotiated between OECD members, but also in tax treaties involving non-members. The "new" OECD model tax convention expressly stipulates that the revision process of the model has been opened up to include input from non-member countries; accordingly, the OECD model reflects the views of more than simply the OECD's member countries.

Where the OECD model tax convention or commentary is amended after the signing of a given treaty, a court may consider the amended version to see what changes were brought about by the amendments and whether Canada has expressed reservations or observations in respect of these amendments, but the version in place at the time of the signing of the treaty should prevail. As stated in the introduction of the OECD model tax convention, tax treaties should, as far as possible, be interpreted in the spirit of the revised model and commentary, even where the provisions of these treaties do not themselves include the more precise wording

[43] These views could be found in the published administrative positions of the other treaty partner or even in its judicial decisions.

of the current version of the model and commentary.[44] However, the OECD recognizes that, in some instances where the amendments to the OECD model and commentary differ in substance from the provisions of specific tax treaties, these amendments will not be relevant to the application and interpretation of those tax treaties. At the same time, the OECD disagrees with any interpretation that would compare one version of the OECD model or commentary with an earlier one to infer that the changes or amendments mean that the provision in question had a different meaning at a different time. The reason is that most amendments and changes are meant to clarify, not alter, the meaning of the various provisions of the OECD model and commentary.

The Court's Use of the OECD Model and Commentary

Returning to the *Crown Forest* decision, the court found the OECD model tax convention to be of "*high persuasive value* in terms of defining the parameters"[45] of the convention, and it relied heavily on the OECD model and its commentary to bolster its conclusion:

> The authority for the proposition that only those who are liable to tax on their world-wide income can be justifiably considered residents for the purposes of international taxation conventions is found in the first sentence in Art. 4 of the O.E.C.D. Model Convention and the absence of the second sentence in the *Canada-United States Income Tax Convention (1980)* does not detract therefrom. This is because the second sentence is relevant to a situation in which a person is considered a resident under domestic law but where that person, by reason of a special privilege, nevertheless is not subject to tax on the basis of world-wide income. Paragraph 8 of the Commentary to Art. 4 of the O.E.C.D. Model Convention addresses this point:
>
> > In accordance with the provisions of the second sentence of paragraph 1, however, a person is not to be considered a "resident of a Contracting State" in the sense of the Convention if, although not domiciled in that State, he is considered to be a resident according to the domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State. That situation exists in some States in relation to individuals, e.g., in the case of a foreign diplomatic and consular staff serving in their territory.[46]

In addition to the OECD model tax convention and commentary, the court referred to the UN model convention, article IV.[47] Although that provision does not contain the second sentence in article 4(1) of the OECD model, it

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[44] See, for example, *The Taisei Fire and Marine Ins. Co., Ltd.*, 104 TC 27 (1995), where the court decided to rely on a version of the commentary on the OECD model that was in place after the ratification of the tax treaty being interpreted and that contradicted the literal language of the commentary in effect at the time the treaty was ratified.

[45] Supra footnote 24, at 5398 (emphasis added).

[46] Ibid., at 5398-99.

[47] The United Nations Model Bilateral Double Taxation Convention Between Developed and Developing Countries: Tax Treaties Between Developed and Developing Countries, Eighth Report, December 10-21, 1979, UN Publ. no. E80.XVI.I.

states that, in order for a person to be considered a resident of a contracting state, that person must be liable to tax in that state on worldwide income.

The court then moved on to conclude that the second sentence found in article 4(1) of the OECD model was omitted from article IV(1) of the Canada-US convention, not in order to indicate a change in meaning, but because it was not necessary for the purposes of the convention since it would have been meaningless. The court explained the presence of other "meaningless" terms in article IV(1) of the Canada-US convention by accepting the intervener's position that these terms were not removed "in order to preserve overall conformity with" the OECD model tax convention.[48]

One might ask why the second sentence also was not kept, if conformity with the OECD model was indeed the intent of the parties.[49] This is an inconsistency that is not fully explained, and perhaps cannot be fully explained, by the court's decision. Perhaps, in order to resolve this issue, any departure in meaning or in concept from the OECD model tax convention in any of Canada's tax treaties should, from now on, be evidenced in the form of a technical explanation accompanying the change, by press release, or through reservations by Canada noted in the OECD model tax convention and commentary.[50]

The Federal Court of Appeal and the Supreme Court differed in their use of the OECD model tax convention in interpreting the Canada-US convention. The Federal Court, without reference to the Vienna convention, used the OECD model a contrario to determine the intention of the drafters of the Canada-US convention, whereas the Supreme Court, after referring to the Vienna convention and the use of extrinsic materials, looked to the OECD model and commentary to confirm its interpretation of the plain language meaning of the provisions of the Canada-US convention.

Consequences of the Court's Decision

Although the decision leaves certain questions unanswered, it is nevertheless of great importance in that it confirms the long-held view that the OECD model tax convention and commentary have a place in the interpretation of tax treaties in Canada. The words used by the court, "high persuasive value," and the two-part analysis approach will most likely dictate that the lower courts will, in every case, look to the OECD model and commentary when interpreting Canada's various tax treaties. The OECD

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[48] Supra footnote 24, at 5400.

[49] Again, see the comments in footnote 19, supra.

[50] It is worth noting that both Canada and the United States have reservations on article 4 of the current OECD model tax convention. These reservations read as follows:

> *Canada* reserves the right to use as the test for paragraph 3 the place of incorporation or organisation with respect to a company.
>
> The *United States* reserves the right to use a place of incorporation test for determining the residence of a corporation, and, failing that, to deny dual resident companies benefits under the Convention.

model and commentary will probably form part of any subsequent judgment of the lower courts whether explicitly or implicitly as a confirmation of the court's conclusions.

Taxpayers also may be better able to determine the meaning and proper interpretation to be attached to the provisions of Canada's tax treaties by referring directly to the commentary of the OECD model tax convention and by ensuring that Canada has not made a reservation or observation on the issue in question.[51] It may also be helpful to ascertain whether Revenue Canada has published a contrary position on the issue.

For instance, if one wanted to know whether a Canadian taxpayer is entitled to know if and what information has been provided to Revenue Canada by the IRS, the commentary on the OECD model tax convention could be helpful. Article XXVII of the Canada-US convention and the accompanying technical explanation state that such information can be disclosed only to persons or authorities involved in the assessment or collection of, the administration and enforcement in respect of, or the determination of appeals in relation to, the taxes covered by the convention. Clarification can be found in the commentary on article 26 of the OECD model. The commentary, at paragraph 12, states that the information obtained through the exchange-of-information provisions may be communicated to the taxpayer or his proxy or to witnesses. No observation or reservation was registered by Canada on this commentary or on article 26. This is only one example of the "new" possibilities that have been given weight by the judgment of the Supreme Court in *Crown Forest*.

In order for Revenue Canada to argue against the meaning and explanation found in the OECD model tax convention and commentary, it would have to demonstrate clearly that the interpretation found in the OECD materials is inapplicable to the provision of the tax treaty or to the Canadian situation in general. In the absence of a reservation or observation on the article and commentary in question, this may constitute a very large obstacle to overcome.

CONCLUSION

The Supreme Court's judgment in *Crown Forest* clearly places the OECD model tax convention and commentary in a prominent position in the landscape of materials available to tax practitioners to assist in the interpretation of tax treaties. In my view, the weight given to the OECD model tax convention by the words "high persuasive value" could be tantamount to putting the OECD model on an equal footing with, for instance, the technical explanation to the Canada-US convention pursuant to article 31 of the Vienna convention. In any event, practitioners should give consideration to the OECD model tax convention and commentary in any future interpretation of Canada's tax treaties.

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[51] Canada has expressed observations or reservations on articles 2, 4, 8, 10, 11, 12, 13, 17, 18, 19, 21, 24, and 25 of the current OECD model tax convention and commentary.

The court's judgment may also pave the way for the general acceptance by Canadian courts of other materials reflecting international consensus, such as the OECD's published works on transfer pricing. However, the inclusion of such materials in the Canadian context may be slightly more problematic because the courts will not be able to rely, contrary to the case of tax treaties, on the provisions of the Vienna convention and each treaty's enacting legislation in Canada.