Tax Treaty Interpretation: Determining Domestic Meaning Under Article 3(2) of the OECD Model

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PRÉCIS
Toutes les conventions fiscales du Canada actuellement en vigueur contiennent une disposition semblable ou identique au paragraphe 3(2) de la convention fiscale modèle de l’Organisation de coopération et de développement économiques. Cette règle spéciale d’interprétation des traités prévoit essentiellement que, sauf si le contexte exige une interprétation différente, tout terme qui n’y est pas défini a le sens que lui attribue, à ce moment, le droit de l’État qui applique la convention. Cet article traite de la référence au droit interne et met notamment l’accent sur la pertinence et l’application des règles d’interprétation du droit interne pour dégager la signification du terme non défini dans la convention, conformément au paragraphe 3(2).

L’analyse de l’auteur propose deux facteurs connexes qui sont pertinents pour cette détermination : premièrement, il est important d’évaluer si le terme non défini dans la convention est utilisé dans le droit interne dans le contexte de la disposition qui établit l’obligation fiscale limitée par la convention et deuxièmement, la détermination de la signification nationale la plus appropriée d’un terme non défini dans la convention est une question d’interprétation selon le droit interne seulement. L’auteur fait valoir que, peu importe que le terme non défini soit utilisé dans l’État qui applique la convention dans le même contexte que celle-ci, la signification la plus appropriée aux fins du paragraphe 3(2) doit être évaluée en fonction de la disposition pertinente du droit interne dans son contexte national et à la lumière de son objet national, nonobstant la convention. Généralement, cette méthode favorise la coordination entre la convention et le droit interne. Cependant, l’interprétation selon les règles du droit interne ne permet pas toujours à la signification nationale d’un terme non défini dans la convention d’atteindre les objectifs politiques qui sont propres à la convention. Finalement, en intégrant cette analyse à l’exception du « contexte » du paragraphe 3(2), l’auteur conclut que tous les éléments qui sont pertinents pour la détermination du sens national d’un

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terme non défini dans une convention devraient être pris en considération pour établir si, dans un cas particulier, le contexte exige qu’une interprétation différente soit utilisée.

**ABSTRACT**

All of Canada’s tax treaties that are currently in force contain a provision that is similar or identical to article 3(2) of the model tax convention of the Organisation for Economic Co-operation and Development. This special rule of treaty interpretation essentially directs that, unless the context otherwise requires, an undefined treaty term must be given the meaning it has under the law of the state applying the treaty. This article examines the reference to domestic law and focuses in particular on the relevance and application of domestic rules of interpretation in determining the domestic meaning of undefined treaty terms under article 3(2).

The author’s analysis suggests two related factors that are relevant to this determination: first, it is important to consider whether the undefined treaty term is used in domestic law in the context of the provision that establishes the tax liability that the treaty restricts; and second, discovering the one most appropriate domestic meaning of an undefined treaty term is a matter of domestic interpretation only. The author argues that, whether or not the undefined treaty term is used domestically in the same context as in the treaty, the most appropriate domestic meaning for the purposes of article 3(2) must be ascertained by reference to the relevant domestic charging provision in its domestic context and in light of its domestic purpose, without regard to the treaty. Generally, this approach ensures proper coordination between the treaty and domestic law. However, domestic interpretation may not allow the domestic meaning of an undefined treaty term to meet any policy objectives that are specific to the treaty. Finally, integrating this analysis with the “context” exception in article 3(2), the author concludes that all elements that are relevant in determining the domestic meaning of an undefined treaty term should be considered in determining whether in a particular case the context requires that an alternative interpretation be used.

**KEYWORDS:** TREATIES ■ INTERPRETATIONS ■ INTERNATIONAL TAXATION

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INTRODUCTION

Canada has over 80 tax treaties that are generally patterned on the Organisation for Economic Co-operation and Development’s Model Tax Convention on Income and on Capital (“the OECD model”). All of Canada’s treaties contain a provision that is similar or identical to article 3(2), which directs that, unless the context otherwise requires, an undefined treaty term must be given the meaning it has under the law of the state applying the treaty. The meaning and function of article 3(2) has been the subject of intense debate in the international tax literature.


This article examines the reference in article 3(2) to the domestic meaning of undefined treaty terms. Specifically, the analysis focuses on the relevance and application of domestic rules of interpretation in determining the domestic meaning of undefined treaty terms under article 3(2).

The first part of this article reviews the rules of interpretation generally applicable to tax treaties. The second part examines situations, mostly derived from Canadian and foreign jurisprudence, that involve the interpretation of an undefined treaty term in light of its domestic use and meaning(s), and then explores how domestic rules of statutory interpretation are to be applied in determining the domestic meaning of an undefined treaty term under article 3(2). The third part of the article integrates this analysis with a consideration of when “the context otherwise requires” for the purposes of article 3(2).

**INTERPRETATION OF TAX TREATIES**

**Legal Interpretation in General**

Because this article deals with the interpretation of tax treaties, it is appropriate to begin by discussing what the process of legal interpretation involves in general.\(^3\) To start with, the notion of interpretation has different meanings; thus, the word “interpretation” must itself be interpreted. In a broad sense, interpretation may refer to any kind of explanation, understanding, or theorizing.\(^4\) In a narrower sense, though, “interpretation” can be defined as an understanding or explanation of the meaning of an object.\(^5\)

In law, interpretation may be defined as an intellectual activity that gives meaning to a legal text (or another manifestation of the intention to create a legal norm)
to the extent that the text can bear such meaning in its language. Thus, to interpret a legal text is to decide rationally which of the text’s semantic meanings constitutes its proper legal meaning. Systems of interpretation in law determine the standards to be applied by interpreters in extracting the legal meaning of a text from a variety of meanings. Rules of interpretation are part of the system of law, and interpreters must abide by them. They determine the meaning of a legal text, and that meaning varies according to the system of interpretation. Systems of interpretation diverge significantly on the fundamental point of what should be the appropriate balance between form (language, text) and substance (intention, purpose). This results in a multiplicity of systems of interpretation in law and, thus, a variety of possible meanings for the legal text in question. Hence the importance of ascertaining the applicable rules of interpretation.

**Rules of Interpretation for Tax Treaties**

Tax treaties are designed to facilitate economic relations between countries by attempting to solve the problems created by double taxation. However, no treaty can expressly resolve all issues that may arise in the course of its application. Thus, like any other legal text, tax treaties require and leave room for interpretation.

The essence of the process of interpretation, as briefly described above, is no different in respect of tax treaties than for other legal texts. This is reflected in the words of Iacobucci J of the Supreme Court of Canada:

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.

Canadian courts, as final arbiters in interpreting Canada’s tax treaties, have generally applied principles of interpretation to treaties that are different from those applicable to domestic statutes:

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6 Barak, supra note 3, at 3 and 18ff.

7 Like other legal rules, the rules of interpretation actually consist of both principles and rules. For a discussion of this distinction, see R.M. Dworkin, *Taking Rights Seriously* (London: Duckworth, 1977), 22.

8 See Barak, supra note 3, at 26-30. Systems of interpretation also differ in respect of several secondary issues: (1) whether the substance of a legal text is the subjective intent of the text’s author or the objective goal of a reasonable author; (2) assuming that the intent of the author is relevant, whether the intent of the author is his “true” intent, ascertainable from any source, or the intent expressed in the legal text itself; and (3) what is the objective substance of a legal text and how it is to be determined.

9 Barak, supra note 3, at 30-37.

10 See the introduction to the commentary on the OECD model.

Contrary to an ordinary taxing statute 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.  

It is also accepted that the rules of interpretation contained in the Vienna Convention on the Law of Treaties\(^\text{13}\) (VCLT) reflect generally accepted rules of international law\(^\text{14}\) and are to be applied to Canada’s tax treaties.\(^\text{15}\)

VCLT article 31 sets out the general rule of interpretation for treaties. It contains three separate principles.

The first principle is the foundational idea that a treaty must always be interpreted in good faith.

The second principle is that the words used in a treaty should be given their ordinary meaning. This principle is based on the view that the ordinary meaning of the words of the treaty must be presumed to be the authentic expression of the intention of the parties. This presumption is rebuttable: article 31(4) provides that a special meaning shall be given to a term if it is established that the parties so intended.

The third principle is that the ordinary meaning to be given to the words of the treaty be determined, not in isolation, but “in the context of the treaty in the light of its object and purpose.”\(^\text{16}\) With respect to this last principle, article 31(2) states that, for the purposes of the interpretation of a treaty, “context” comprises, in addition to the text of the treaty, including its preamble and annexes, two additional elements: (1) any agreement relating to the treaty that was made between all parties in connection with the conclusion of the treaty; and (2) any instrument that was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. Thus, “context” for the purposes of the VCLT includes the overall scheme of the treaty.

Article 31(3) lists three further elements of interpretation that must be taken into account: (1) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (2) any subsequent practice in the application of the treaty that establishes the agreement of the parties regarding its interpretation; and (3) any relevant rules of international law applicable in the relations between parties.

Besides the general rule of interpretation in article 31, VCLT article 32 provides for recourse to “supplementary means of interpretation,” such as preparatory work.

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12 Gladden Estate v. The Queen, 85 DTC 5188, at 5191 (FCTD) (emphasis added), applied in Crown Forest, supra note 11, at 5396.


14 These rules are acknowledged to represent a codification of customary international law: see Avery Jones et al., supra note 2, at 15. See generally D.J. Harris, Cases and Materials on International Law, 6th ed. (London: Sweet & Maxwell, 2004), 832-44.

15 Hunter Douglas Ltd. v. The Queen, 79 DTC 5340 (FCTD).

16 Paragraph 12 of the commentary on VCLT article 31.
of the treaty and the circumstances of its conclusion. Such means of interpretation may be used in order to confirm the meaning resulting from the application of the general rule of interpretation, or to determine the meaning when the interpretation according to the general rule leaves the meaning ambiguous or obscure, or leads to a result that is manifestly absurd or unreasonable. Finally, VCLT article 33 concerns the interpretation of treaties authenticated in two or more languages.

Even though the VCLT provides rules for the interpretation of tax treaties, the OECD model also includes a rule in article 3(2), which reads as follows:

As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Notwithstanding the provisions of a convention or the Act giving the convention the force of law in Canada, it is hereby declared that the law of Canada is that, to the extent that a term in the convention is

(a) not defined in the convention,
(b) not fully defined in the convention, or
(c) to be defined by reference to the laws of Canada,

that term has, except to the extent that the context otherwise requires, the meaning it has for the purposes of the Income Tax Act, as amended from time to time, and not the meaning it had for the purposes of the Income Tax Act on the date the convention was entered into or given the force of law in Canada if, after that date, its meaning for the purposes of the Income Tax Act has changed.

The rule of interpretation set out in article 3(2) reflects the special relationship between a tax treaty and the domestic law of the contracting states. It shows a desire

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17 See Engelen, supra note 2, at chapter 7.
18 Ibid., at chapter 8.
19 RSC 1985, c. I-4, as amended.
20 This provision was introduced to overrule Melford Developments, infra note 93.
to preserve the tax sovereignty of the contracting states and acknowledges that a treaty does not exist in a legal vacuum, but necessarily operates on the basis of the tax laws of the contracting states to which it applies. In this way, article 3(2) has the practical advantage of increasing legal certainty, because taxpayers, administrative authorities, and courts can keep to the meaning of a term that they know from domestic law. Moreover, article 3(2) serves to prevent overloading a tax treaty with definitions that would render its application difficult.

Of course, one potentially negative consequence of reference to domestic law is that in many instances the two contracting states attach different meanings to terms in applying the treaty. The consequence of such diverging meanings may be that double taxation is not eliminated or, conversely, that double non-taxation results. However, it now seems accepted that, at least in regard to the distributive provisions of a tax treaty, such conflict does not arise. This is because article 3(2) operates in regard to “the application of the Convention at any time by a Contracting State.” In this respect, it is only the source state that “applies” article 3(2); the residence state should content itself with ensuring that the source state has levied tax in accordance with the provisions of the treaty when providing double taxation relief.

Article 3(2) is drafted in mandatory language: it states that any undefined term shall have the meaning that it has under the domestic law of the state applying the treaty, unless the context otherwise requires. Thus, prima facie, the domestic legal meaning of the treaty term must always be used. The only specific exception to this rule is that the context may require the application of a different meaning. Whether and when the context may so require, in principle, is a matter for debate (though discussed only briefly in this article). Ultimately, it is a question of the interaction between the interpretation rule in article 3(2) and the system of interpretation contained in the VCLT.

**Relationship Between Article 3(2) and VCLT Articles 31 and 32**

According to the OECD, article 3(2) is a “general rule of interpretation.” Neither the OECD model nor the commentary on it refers to the VCLT and its relationship to article 3(2). At the same time, the relationship between article 3(2) and the VCLT has been the subject of intense debate in the international tax literature. The essence

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21 Vogel, supra note 2, at 209.
22 Ibid., at 208-9.
23 Paragraph 32.1ff. of the commentary on articles 23A and 23 B of the OECD model. This interpretation was first put forward in Avery Jones et al., supra note 2, at 50. See also John F. Avery Jones, “The Interaction Between Tax Treaty Provisions and Domestic Law,” in Maisto, Tax Treaties and Domestic Law, supra note 2, 123-58, at 123-32. See Vogel, supra note 2, at 211-12.
24 See below under the heading “‘Unless the Context Otherwise Requires.’”
25 Paragraph 11 of the commentary on article 3 of the OECD model. There have been no reservations to article 3(2) and no observations pertaining to the relevant commentary.
26 See the sources cited in this section and, more generally, other publications listed in note 2, supra.
of the controversy can be translated in terms of the appropriate hierarchy of different interpretive methods that may be used to establish the meaning of undefined treaty terms.\textsuperscript{27}

The prevailing view today seems to be that article 3(2) is a special rule in relation to VCLT articles 31 and 32 and thus takes precedence over those general rules.\textsuperscript{28} Alternatively, it has been argued by some commentators that the domestic law reference in article 3(2) is essentially a rule of last resort with respect to the other general rules of interpretation.\textsuperscript{29} This divergence in views concerns the relative weight to be given to the text of article 3(2) on the one hand and the context and purpose of the tax treaty on the other.\textsuperscript{30}

The various positions on this question are not always easily distinguishable and may lead to the same conclusions. Thus, for example, commentators on both sides have argued that it makes little or no difference whether a tax treaty actually includes a provision similar to article 3(2).\textsuperscript{31} Arguably, this view is not correct. Presumably, by choosing to include an interpretation provision such as article 3(2) in a tax treaty, two contracting states opt to modify the general rules of interpretation normally applicable to international agreements. It is a general principle of international law that if such a provision is included in a treaty, it should be interpreted in such a way that a reason and meaning can be attributed to it.\textsuperscript{32}

The cases discussed below seem to show that judges typically adopt an integrated approach to tax treaty interpretation in that they do not always seek to establish the proper relationship between the VCLT and the applicable equivalent of article 3(2). The following analysis may be splitting hairs insofar as it adopts exactly the opposite approach and may, at times, appear to be legalistic. The point, however, is to improve the understanding of article 3(2) and to show the prevalent importance of domestic rules of interpretation in determining the meaning of undefined treaty terms. Specifically, the following discussion shows that the reference to domestic law in article 3(2) essentially shifts the issue of interpretation to the domestic level\textsuperscript{33} and that the wording of the exception to the main rule in article 3(2) demonstrates a preference for interpretation in accordance with domestic rules.\textsuperscript{34}

\textsuperscript{27} See van der Bruggen, supra note 2, at 143.
\textsuperscript{28} Vogel, supra note 2, at 209; and Engelen, supra note 2, at 477ff.
\textsuperscript{29} This position is propounded by the members of “the Vienna school”: see Heinrich and Moritz, supra note 2, at 149; and Edwardes-Ker, supra note 2, at heading 7.10.
\textsuperscript{30} See Engelen, supra note 2, at 474-76.
\textsuperscript{31} See Engelen, ibid., at 477-81; and van der Bruggen, supra note 2, at 154-56.
\textsuperscript{33} See Reimer, supra note 2, at 473.
\textsuperscript{34} See Vogel, supra note 2, at 210.
MEANING DETERMINED UNDER THE LAW OF THE STATE APPLYING THE TREATY

General Considerations

The focus of this core section of the article is the reference to the domestic law meaning of an undefined treaty term in article 3(2). Article 3(2) states that an undefined treaty term must, unless the context otherwise requires, be given the meaning it has under the law of the state applying the treaty. It specifies that the domestic meaning to be used is the meaning established by reference to the domestic law of the state as modified from time to time. Only the meaning under the law for the purposes of the taxes to which the treaty applies is to be used and then any domestic tax meaning must prevail over any domestic non-tax meaning.

The wording of article 3(2) suggests that this rule is very broad since it applies to any term not defined in the treaty. It is not restricted to any particular parts of the treaty, such as the distributive provisions. In theory, this makes it applicable to almost any word or expression in the OECD model, which includes definitions for very few terms. Moreover, some of those definitions are not exhaustive but inclusive, and even exhaustive definitions may contain undefined terms, to which article 3(2) would apply.

Significantly, article 3(2) refers to “the” meaning that the undefined term has under the domestic law of the state applying the treaty, as if an undefined treaty term could have only one definite meaning. This, however, is far from true. As will be shown in the next section, an undefined treaty term may derive its domestic legal meaning from a variety of sources and may have multiple meanings. Determining what those meanings are and which one is to be used for the purposes of article 3(2) is a matter of domestic statutory interpretation. The discussion that follows will explore the scope of the reference in article 3(2) to the domestic law of the state applying the treaty and the relevance of domestic statutory interpretation in determining the most appropriate domestic meaning of undefined treaty terms under article 3(2).

Sources of Domestic-Law Meaning for an Undefined Treaty Term

1. The Term Is Exhaustively Defined in the Domestic Tax Law

An undefined treaty term may be exhaustively defined in the tax law of the state applying the treaty. An example is the term “employment,” which is relevant to the application of article 15(1) in respect of salaries, wages, and other similar remuneration. “Employment” is not defined in the OECD model, or in Canada’s treaties that include a similar provision. However, the term is defined exhaustively for the purposes of Canada’s Income Tax Act (ITA) to mean “the position of an individual in the

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35 See articles 3(1), 4, 5, 6(2), 10(3), 11(3), and 12(2).
36 See articles 3(1)(b) and (h).
37 An exhaustive definition is denoted by the use of words such as “means” or “is.”
service of some other person.” This definition is applicable to the entire statute and specifically to the provisions in the ITA subjecting the employment income of non-residents to Canadian tax.

In Hinkley v. MNR, the Tax Court of Canada considered the meaning of “employment” in article 15 of the Canada-UK tax convention. In this case, the taxpayer, a resident of the United Kingdom, was hired by an employment agency to work in Canada as an engineer for one of the agency’s corporate clients, Canadair of Montreal. There was no distinction in the way the taxpayer was supervised or how he executed his work as compared with the other permanent employees of Canadair; the only difference was that his legal relationship was with the agency and not with its client. The Canadian tax authority included in the taxpayer’s income the amounts he earned while working in Canada. The taxpayer appealed to the Tax Court of Canada on the basis that, as a resident of the United Kingdom, he was exempt from Canadian tax on his remuneration under article 14 of the Canada-UK tax convention, because he did not have a “fixed base” in Canada.

The taxpayer’s appeal was dismissed. The court found on the evidence that the services provided by the taxpayer were not of an independent nature and thus article 14 of the treaty did not apply. The income derived by the taxpayer instead was held to be income from employment and, by virtue of article 15 of the Canada-UK tax convention, was properly includible in his income subject to Canadian tax. In finding that the relationship between the Canadian employment agency and the taxpayer was one of “employment,” the Tax Court relied on a decision of the Supreme Court of Canada rendered in a labour law case, in which it was held that the relationship between a worker and an employment agency is legally one of employment. The judge refused to follow a Federal Court case in which it had been held, with respect to unemployment insurance legislation, that the contract between an employment agency and the worker could not be considered to be a contract of employment because the services were rendered to a third party.

In reaching the above conclusions, the Tax Court referred to ITCA section 3 and stated, “This section has for purpose, inter alia, to ensure that the terms of the Convention are to be interpreted in accordance with the current case law.” It is notable that the court did not refer to the exhaustive definition of “employment” contained in the ITA. This may be seen as supporting the view that, for the purposes of article 3(2), the domestic law meaning of an undefined treaty term is not necessarily the

38 ITA subsection 248(1), definition of “employment”: RSC 1985, c. 1 (5th Supp.), as amended.
39 ITA subparagraph 115(1)(a)(i) and subsection 5(1).
40 91 DTC 1336 (TCC).
41 The Convention Between Canada and the United Kingdom of Great Britain and Northern Ireland with Respect to Taxes on Income and Capital Gains, signed in London on September 8, 1978, as amended by the protocols signed on April 15, 1980 and October 16, 1985.
43 Hinkley, supra note 40, at 1340.
meaning given by a definition of the term to be found in the relevant tax law. However, the court’s omission of reference to the ITA definition of “employment” does not necessarily mean that article 3(2) allows direct use of a non-tax meaning of an undefined treaty term if the term is defined in domestic tax law. The definition of “employment” in the ITA provides little clarity and itself requires interpretation. A court faced with the definition is naturally led to case-law interpretations of the term, even if these interpretations have been adopted in relation to non-tax matters, as long as the meaning derived from them is applicable for tax purposes.

In determining the domestic meaning of the undefined treaty term “employment,” the court in Hinkley does not seem to have considered the fact that different Canadian provinces may attribute different meanings to an undefined treaty term. With respect to the meaning of “employment,” the tests laid down in the seminal case of Wiebe Door Services Ltd. v. MNR, which has adopted the integration criterion developed in the common law, diverge from those set out in article 2085 of the Civil Code of Québec, which defines a contract of employment as a contract by which the employee undertakes to do work “according to the instructions and under the direction or control of” the employer. A tax treaty case, Wolf v. The Queen, highlights the interpretation issues arising with respect to possibly diverging meanings of “employment” between Quebec and Canada’s common-law provinces. This decision dealt with facts very similar to those in Hinkley but was rendered in favour of the taxpayer. The appellant, who was a citizen of the United States, was employed through a consulting firm as a consulting engineer at Canadair in Montreal during the taxation years 1990 to 1995. He was paid directly by the consulting firm’s client on an hourly basis, together with overtime pay and some benefits. The taxpayer deducted lodging and travel expenses as business expenses. The minister of national revenue (“the minister”) disallowed the business expenses as claimed and declared the taxpayer’s income to be income from employment. The Tax Court dismissed the taxpayer’s appeal and, on the basis of Hinkley, held that he was an employee of the employment agency. This decision was reversed on appeal.

Before the Federal Court of Appeal, the minister did not challenge the Tax Court’s finding that the taxpayer was a resident of the United States for the purposes of the Canada-US tax convention. The minister also conceded that the appellant did not have a fixed base regularly available to him in Canada. Therefore, the sole issue to

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45 See Avery Jones et al., supra note 2, at 25.
46 87 DTC 5025 (FCA).
47 SQ 1991, c. 64, as amended.
48 2000 DTC 2595 (TCC); rev’d. 2002 DTC 6853 (FCA).
be decided on appeal was whether the income derived by the taxpayer was “in respect of independent personal services” within the meaning of article XIV of the convention or “in respect of dependent personal services” within the meaning of article XV. The Federal Court of Appeal held that article XIV applied, and thus the taxpayer was not to be taxed in Canada. Remarkably, each of the three Federal Court justices issued a separate concurring opinion. As the following discussion suggests, each judge appeared to have a different perspective regarding the proper interpretation of the terms “employment” and “independent personal services.”

Desjardins J proceeded on the basis that the distinction between a contract of employment and a contract for services under the Civil Code of Québec 50 can be examined in light of the tests developed through the years both in the civil law and in the common law. However, she essentially relied only on common-law principles. Desjardins J applied the Supreme Court of Canada decision in 671122 Ontario Ltd. v. Sagaz Industries Canada Inc., an Ontario tort case, in which Major J adopted the common-law tests laid down by MacGuigan J in Wiebe Door:

Although there is no universal test to determine whether a person is an employee or an independent contractor, I agree with MacGuigan J.A. that a persuasive approach to the issue is that taken by Cooke J. in Market Investigations, supra [an English Queen’s Bench case, [1968] 3 All ER 732]. The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account. In making this determination, the level of control the employer has over the worker’s activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers, the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker’s opportunity for profit in the performance of his or her tasks.

It bears repeating that the above factors constitute a non-exhaustive list, and there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of the case. 51

In reaching her decision, Desjardins J did not refer to either article III(2) of the Canada-US tax convention (which is similar to OECD article 3(2)) or ITCA section 3. In a separate opinion, Décary J began his analysis specifically with article III(2) of the convention. The judge stated that in interpreting the concepts of “independent contractors” and “employees,” common-law rules apply if the contract at issue is to be interpreted in accordance with the laws of a province other than Quebec, and the Civil Code of Québec applies if the contract at issue is to be interpreted in accordance

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50 It was accepted that the Civil Code of Lower Canada (c. 41 of the statutes of 1865 of the Legislature of the Province of Canada, as amended) would apply to the 1990, 1991, 1992, and 1993 taxation years and the Civil Code of Quebec would apply for the 1994 and 1995 taxation years. It was accepted that there is no difference in law between the relevant provisions of the Civil Code of Quebec and those of the Civil Code of Lower Canada.

with the laws of Quebec. In this respect, Décary J noted section 8.2 of the federal Interpretation Act, which provides that “when an enactment contains both civil law and common law terminology, or terminology that has a different meaning in the civil law and the common law, the civil law terminology or meaning is to be adopted in the Province of Quebec and the common law terminology or meaning is to be adopted in the other provinces.” The judge examined whether the Civil Code of Québec was properly applicable to the contractual relationships at issue and concluded that it was. Then he went on to correctly adopt an approach that was more closely in line with the criteria set out in the Civil Code of Québec than the analysis of Desjardins J:

> [W]hat fundamentally distinguishes a contract for services from a contract of employment is the absence in the former of a “relationship of subordination” between the provider of services and the client (art. 2099 C.C.Q.) and the presence in the latter of the right of the employer to “direct and control” the employee (art. 2085 C.C.Q.); that the very same services may be provided under either type of contract; that in either type of contract the necessary tools may be provided by the hiring person (art. 2103 C.C.Q.); and that the legal characterisation of either type of contract is determined in each case by the terms of the contract and by the circumstances. . . .

The test, therefore, is whether, looking at the total relationship of the parties, there is control on the one hand and subordination on the other.

Finally, in a brief opinion, Noël J thought that none of the legal tests set out by the other justices were conclusive and, therefore, since there was no sham or window dressing, the way the parties viewed their relationship was determinative.

2. The Term Is Explained in the Domestic Tax Law

An undefined treaty term may not be exhaustively defined in the domestic law of the contracting state applying the treaty, but its meaning may be determinable through a formula or otherwise. For example, a treaty article modelled on article 13 applies to “gains” derived from the alienation of property by a resident of a contracting state. The word “gain” is not defined in the ITA, yet its meaning is easily determinable. ITA subparagraph 40(1)(a)(i) provides that a taxpayer’s gain from the disposition of any property is “the amount . . . by which the taxpayer’s proceeds of disposition exceed the total of the adjusted cost base to the taxpayer of the property immediately before the disposition and any outlays and expenses to the extent that they were made or incurred by the taxpayer for the purpose of making the disposition.”

In AG of Canada v. Kubicek Estate, the Federal Court of Appeal considered the meaning of the term “gain” in the Canada-US tax convention. That case concerned

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52 RSC 1985, c. I-21, as amended. Section 8.2 was added by an amendment effective from 2001.
54 97 DTC 5454 (FCA).
the computation of the capital gain realized upon death by the deceased taxpayer, a US resident, on a deemed disposition of a cottage situated in Canada. The court held that since “gain” is not defined in the Canada-US tax convention, pursuant to article III(2) the meaning had to be determined under Canadian tax law. According to the court, the convention did not require that the term be defined in the domestic tax law, but only that its meaning could be derived from it. Accordingly, the meaning of “gain” could be derived from ITA subsection 40(1), which sets out the method to be used in computing a capital gain for Canadian income tax purposes. The result was that the reduction in capital gains tax was to be calculated from the date when the gain first began to accrue (that is, December 31, 1971). In drawing this conclusion, the court rejected the analysis of the Tax Court, which held that the domestic legislation must actually define the term in question in order to apply.

3. The Term Is Used but Not Defined or Explained in the Domestic Tax Law

Where an undefined treaty term is used in the domestic tax law but is not defined or otherwise explained, the appropriate meaning of the undefined term is to be determined through further interpretation. Considering the highly complex and technical drafting style of the ITA, undefined terms that have a legal meaning must be given that meaning. Terms used in a commercial context within the ITA are to be given the meaning they have in a commercial or accounting sense. Where a term used in the ITA does not have a particular legal or commercial meaning, the meaning is to be derived from everyday usage.

To illustrate the first of these rules of statutory interpretation—that an undefined term that has a legal meaning should be given that meaning—a simple example is the reference to director’s fees in article 16. The word “director” is not defined in the OECD model. The term is used in the ITA but not defined. “Director” has a reasonably clear and well-established meaning under Canadian federal and provincial corporate law. Of course, this word also has an ordinary meaning; however, in

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55 The cottage was purchased on September 19, 1967. In Canada, only capital gains accrued after December 31, 1971 are taxable. The specific issue in the case was whether, for the purpose of computing the exempt portion of the deemed gain, the accrual period started from September 19, 1967 or from December 31, 1971.

56 See Haas Estate v. The Queen, 99 DTC 1294 (TCC). See also Beame v. The Queen, 2004 DTC 6102 (FCA) regarding the meaning of “income.”

57 See Kubicek Estate v. The Queen, 97 DTC 1552, at 1553 (TCC).


59 See, for example, the Canada Business Corporations Act, RSC 1985, c. C-44, as amended, section 2(1) and part X.

60 For example, as defined in Webster’s Ninth New College Dictionary, 1990: “one that directs: as a : the head of an organized group or administrative unit (as a bureau or school) b : one of a
interpreting the ITA, the legal meaning of “director” must be preferred to its ordinary meaning. Since the corporate law meaning of the term must be used for the purposes of the ITA, including the application of the charging provision governing the taxation of director’s fees, arguably it is equally appropriate to use this meaning for the purposes of a treaty article based on article 16.

This conclusion would likely also be reached by the Supreme Court of the Netherlands, as is suggested by its decision of December 22, 1999. This case involved a claim by the Netherlands tax authority for wage withholding tax on fees paid by a Netherlands-resident company to two non-residents (residents of Malaysia and Colombia respectively) who served as vice-presidents of the company but were not members of its board of directors. The tax inspector claimed that the two non-residents were “directors” of the company for the purposes of article 2(3) of the Netherlands Wage Withholding Tax Act 1964. The Supreme Court held in favour of the taxpayer that no withholding was required on the basis of the private-law definition of the term “director.” The court held that the decisive factor was not the actual activities performed by the two non-residents, but the status of their position as laid down in the articles of association of the company. The court did not refer to the Netherlands-Malaysia tax convention, nor did it need to do so, considering its conclusion on the application of the domestic taxing provision. However, it has been pointed out that the court’s decision should not be different with respect to treaties that follow the Netherlands model tax treaty.

The apparent simplicity of the above example is to be contrasted with the complexity involved in interpreting another undefined treaty term, “beneficial owner.” Under the OECD model, the notion of beneficial ownership is important for determining whether a person qualifies for tax treaty benefits in respect of dividends, interest, and royalties. Specifically, the expression “beneficial owner” and its variant “beneficially owned” are used in articles 10, 11, and 12, but without being defined for those purposes. “Beneficial owner,” “beneficial ownership,” and “beneficially owned” are used in several provisions of the ITA; however, none of those provisions deal with

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61 See Will-Kare Paving & Contracting Limited v. The Queen, 2000 DTC 6467, at paragraph 31 (SCC), where the court held that, for tax purposes, the private-law meaning of the word “sale” must prevail over its ordinary meaning. See also Rezek et al. v. The Queen et al., 2005 DTC 5373, at paragraph 48 (FCA).

62 ITA section 6(1)(c).


64 The Netherlands has no tax treaty with Colombia.


66 “Beneficial owner” and its variant forms occur 18 times in the current legislation.
the taxation of dividends, interest, or royalties. The ITA does not define these expressions. This is understandable, because the distinction between legal owner and beneficial owner is well established in equity, and it plays a critical role in the legal systems of common-law jurisdictions, such as England, the United States, and Canada (excluding the civil-law province of Quebec). In essence, a beneficial owner is “[o]ne recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else.”

The tax treaty notion of beneficial ownership is at issue in *Prevost Car v. The Queen*, a case that is currently before the Tax Court of Canada. The Canadian-resident corporate taxpayer in this case, Prevost Car Inc. (“Prevost”), is a manufacturer of motor coaches based in Quebec. In 1995, Volvo Bussar AB (“Volvo”), a Swedish company, and Henlys Group PLC (“Henlys”), a UK company, entered into a joint venture arrangement to acquire the shares of the appellant. The acquisition was carried out in 1995 by Volvo’s acquiring all of the shares of the appellant, which were transferred shortly thereafter to a wholly owned Dutch subsidiary, Provost Holding B.V. (“Holding”). Volvo then sold 49 percent of the shares of Holding to Henlys. Each year, from 1996 through 2001, Prevost paid dividends to Holding and withheld and remitted withholding tax at the rate of 5 percent (6 percent for 1996), which was the applicable rate of withholding under the Canada-Netherlands tax convention. The minister reassessed the withholding tax with respect to these dividend payments on the basis that Holding was not the “beneficial owner” of the dividends for the purposes of the Canada-Netherlands tax convention, and therefore the appellant should have withheld at the rates of 15 percent and 10 percent pursuant to the Canada-Sweden and Canada-UK tax conventions respectively.

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68 *Black’s Law Dictionary*, 7th ed. More detailed definitions can be derived from the case law. For example, in *Ayerst v. C & K Ltd.*, [1975] STC 345, at 349 (HL), Diplock LJ defined “beneficial ownership” as follows: “My Lords, the concept of legal ownership of property, which did not carry with it the right of the owner to enjoy the fruits of it or dispose of it for his own benefit, owed its origin to the Court of Chancery. The archetype is the trust. The ‘legal ownership’ of the trust property is in the trustee, but he holds it not for his own benefit but for the benefit of the cestui que trustant or beneficiaries. On the creation of a trust in the strict sense as it was developed by equity the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the ‘legal ownership’ in the trustee, and what came to be called the ‘beneficial ownership’ in the cestui que trust.” Although the expression “beneficial owner” has a reasonably well-established meaning in common-law systems, the notion is riddled with fine distinctions and ongoing controversies: see generally Brown, *infra* note 85.

69 Docket nos. 2004-4226(IT)G and 2004-2006(IT)G. This is the first case in which the Tax Court of Canada will have to consider the “beneficial ownership” requirement in the treaty context. The hearing of the case is scheduled to begin on September 4, 2007.

70 In the pleadings before the Tax Court, the minister now argues that the treaties with Sweden and the United Kingdom are not relevant and that the 25 percent statutory withholding rate under ITA section 212 must apply.
issue before the Tax Court is whether Holding was the “beneficial owner” of the dividends paid to it by Prevost in the years at issue for the purposes of the Canada-Netherlands tax convention.

In analyzing this issue, the Tax Court will likely note the recent and controversial UK decision in *Indofood International Finance Ltd. v. J.P. Morgan Chase Bank*,71 which interpreted the term “beneficial owner” in the tax treaty context. This commercial-law case involved an issuer of loan notes (“the issuer”), which sought a declaration that it was entitled to redeem such notes. The defendant in the case was the trustee and paying agent in respect of the notes. The issuer was incorporated in Mauritius for the sole purpose of issuing the notes and was a wholly owned subsidiary of an Indonesian public company (“the parent”). In 2002, the parent wished to raise capital by the issuance of loan notes on the international market. Had it done so itself, it would have been subject to a 20 percent Indonesian withholding tax on the interest payable to the noteholders. This liability could be reduced to 10 percent under the Indonesia-Mauritius tax convention72 if the loan notes were issued by a wholly owned subsidiary incorporated in Mauritius and the capital so raised was on-loaned to the parent. These considerations led to the incorporation of the issuer and the issuance of the notes by it. The note conditions provided that the notes would be redeemed at par on June 18, 2007, but might be redeemed earlier if there were a change in the law of Indonesia whereby the obligation of the parent to deduct withholding tax from the interest payable to the issuer would exceed the 10 percent rate then provided for in the Indonesia-Mauritius tax convention. In the event of such a change, the issuer might redeem the loan notes earlier if and only if such obligation could not be avoided by the issuer “taking reasonable measures available to it.” When Indonesia terminated its treaty with Mauritius, effective January 1, 2005, the withholding rate on the interest payments from the parent to the issuer increased to 20 percent. Moreover, by then both interest and exchange rates had moved against the parent and in favour of the noteholders. Accordingly, since it was in the interests of the parent that the notes be redeemed as soon as possible, the issuer gave notice to the defendant of its intention to redeem the notes. The defendant refused to approve the redemption on the ground that it was not satisfied that there were no reasonable measures available to the issuer to avoid the increased liability for withholding tax. Hence the court action.

At the hearing, it was accepted that the only reasonable measure to be considered was the interposition of a company incorporated in the Netherlands (“Newco”)


72 The Agreement Between the Government of the Republic of Mauritius and the Government of the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Jakarta on December 10, 1996. This tax convention was terminated effective January 1, 2005.
between the issuer and the parent. The main substantive issue was whether Newco would be the “beneficial owner” of the interest payable to it by the parent for the purposes of the reduced withholding tax rate in article 11 of the Indonesia-Netherlands tax convention.73 The issuer (which, a priori, was interested in obtaining the lower treaty withholding rates on interest) was in the paradoxical situation of claiming that it was not, and (if and when interposed) Newco could not be, the beneficial owner of the interest receivable from the parent, from the perspective of Indonesia. In the High Court, Evans-Lombe J held against the issuer and decided that Newco would be the beneficial owner of the interest from the parent. In doing so, the judge appears to have applied tests for beneficial ownership that are recognized in English common law.74 Thus, he was of the view that Newco, like the issuer, would not be a nominee or agent for any other party and, not being any sort of trustee or fiduciary, would have power to dispose of the interest it received as it wished, subject to its loan obligation to the issuer. Also, the court tested Newco’s beneficial ownership by reference to the rights of creditors in the event of its insolvency.

The Court of Appeal reversed the High Court’s decision. On the main issue of beneficial ownership,75 the judge thought that the fact that neither the issuer nor Newco was or would be a trustee, agent, or nominee for the noteholders or anyone else in relation to the interest receivable from the parent was by no means conclusive. Nor was the absence of any entitlement of a noteholder to security over or right to call for the interest receivable from the parent. The court relied on the views of the OECD and Philip Baker’s discussion of the OECD commentary76 for an “international fiscal meaning” of the term “beneficial owner.” On the basis of these sources and a publication of the director general of taxes of Indonesia, the judge held that the concept of beneficial ownership is incompatible with that of the formal owner who does not have “the full privilege to directly benefit from the income.”77 The court went on to find that the legal, commercial, and practical structure behind the loan notes was inconsistent in form and in substance with the concept that the issuer or, if interposed, Newco could have enjoyed any such privilege.78 The judge thought these

73 The Agreement Between the Government of the Kingdom of the Netherlands and the Government of the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Jakarta on January 29, 2002. All the issues considered by the High Court are listed at paragraph 23 of its judgment, supra note 71 (Ch.).

74 Indofood, supra note 71, at paragraphs 46-50 (Ch.). See du Toit, supra note 67, at 105–6, regarding tests for beneficial ownership in English law.

75 The issues considered by the Court of Appeal were the following: (1) whether Newco would be the beneficial owner of the interest payable by the parent guarantor; (2) whether Newco would be resident in the Netherlands; and (3) whether the interposition of Newco could be achieved without the creation of a new loan from Newco to the parent guarantor.

76 See Baker, supra note 2.

77 Indofood, supra note 71, at paragraph 42.

78 Ibid., at paragraphs 43-44.
conclusions were consistent with the purpose and object of the treaties at issue as indicated by their respective titles. Accordingly, the Court of Appeal was satisfied that the issuer was not, and (if and when interposed) Newco could not be, the beneficial owner of the interest receivable from the parent for the purposes of article 11(2) of the Indonesia-Mauritius tax convention or article 11(2) of the Indonesia-Netherlands tax convention. Therefore, the court allowed the appeal on the basis that the interposition of Newco was not a measure available to the issuer or the parent to avoid the obligation to pay withholding tax at a rate in excess of 10 percent.

With respect to the interpretation of “beneficial owner,” neither court’s decision is persuasive. Arguably, the apparent difficulty experienced by both courts arises from the fact that in Indofood a common-law non-tax court was asked to interpret, as if it were a civil-law tax court, a common-law non-tax concept contained in a tax treaty concluded between two civil-law countries.

On the one hand, it is questionable whether the analysis of the High Court is correct since the judge seems merely to have determined how a judge of the High Court in England would interpret the term “beneficial owner,” instead of trying to place himself in the shoes of an Indonesian judge. Importantly, however (although this was not the approach adopted by the judge), the High Court decision shows that a judge in a common-law jurisdiction may use article 3(2) of the OECD model to apply domestic notions of beneficial ownership for the purposes of a tax treaty. On the other hand, the outcome of the Court of Appeal decision is also problematic. The court’s heavy reliance on the OECD’s views on the meaning of “beneficial owner” is surprising, given that Indonesia is not an OECD member country; indeed, it was presumptuous of the court to assume that Indonesia would agree with those views in applying the concept of beneficial ownership. The court seems not to have understood that traditional capital-importing countries, such as Indonesia, may sometimes accept treaty shopping and be content with forgoing withholding tax as the price for greater capital inflows. In this respect, the court should have given less weight to the written pronouncements of the Indonesian tax authority and greater weight to the fact that, despite such views (which are not law in any event), the Indonesian tax authority had not challenged the entitlement of the parent to the treaty withholding rate of 10 percent.

In light of the above, the precedential value of Indofood with respect to the meaning of “beneficial ownership” is highly questionable. Thus, the Tax Court of Canada should be very careful, in deciding Prevost Car, not to blindly follow this UK decision.

79 On the basis of article 11(4) of the Indonesia-Netherlands tax convention, the court also accepted that this treaty had as another of its objects the encouragement of long-term foreign loans.

80 It is my understanding that the concept of beneficial ownership is unknown to Indonesian tax and private law.

81 Nor is Mauritius, for that matter.
In *Prevost Car*, the following factors will likely be relevant in interpreting the concept of beneficial ownership:

- First, as stated above, the ITA uses the concept of beneficial ownership in several provisions. While the ITA does not define the term, it is widely recognized that the private-law definition of “beneficial ownership” underlies Canada’s tax law.

- Second, with respect to private law, while the concept of beneficial ownership has a well-established meaning in Canada’s common-law provinces, it has no meaning in Quebec law. The ITA provides a set of deeming rules in subsection 248(3) that attempt to bridge the gap between the common law and the civil law in the application of the ITA, including the concept of beneficial ownership, “in relation to the Province of Quebec”; however, it has been argued that this provision may be insufficient for this purpose and may not prevent inconsistent application of the ITA in Quebec. This factor may be relevant because the taxpayer in *Prevost Car* is based in Quebec. The issue, however, is whether Holding, a non-resident of Canada, was the beneficial owner of the dividends paid to it by Prevost. It is not obvious how nexus to any of Canada’s provinces and the private law applicable therein is to be determined.

- Third, it has been argued that the concept of beneficial ownership has different meanings in the ITA itself, depending on the context. For example, Catherine Brown has identified at least four categories of meaning for the expressions “beneficial ownership,” “beneficial owner,” and “beneficially owned” as used in the ITA in respect of a trust. In the first category, the owner of property is described as the “beneficial owner,” and thus “beneficial ownership” includes ownership by the legal titleholder if that person also has beneficial enjoyment of the property. In the second category, the beneficiary is considered to be the beneficial owner as a result of tax decisions and the operation of the ITA. In these cases, the expressions “beneficial ownership,” “beneficial owner,” and

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82 Quebec, being a civil-law jurisdiction, does not recognize the common-law concept of beneficial ownership.

83 ITA paragraph 248(3)(f) provides that for the purposes of the application of the ITA in relation to Quebec, a property in respect of which any person has certain rights, such as the right of ownership or a right as a beneficiary in a trust, is deemed to be beneficially owned by that person.


“beneficially owned” include ownership by a person where a bare trustee, agent, or other intermediary holds legal title to the property. In the third category, the beneficiary is the beneficial owner of trust property on the basis of private-law principles. Finally, in the fourth category, a trust, being deemed to be an individual for tax purposes, may be considered to be the beneficial owner of the trust property.

In light of these factors, the Tax Court in Prevost Car will have to decide whether the equivalent of OECD article 3(2) in the Canada-Netherlands tax convention is properly applicable in interpreting the concept of beneficial ownership. Arguably, it is. If so, the Tax Court will have to determine the proper domestic meaning of “beneficial ownership” and consider whether the context requires that another meaning be used. In light of the above discussion, it seems likely that the court will find that the context does require the use of another meaning. However, what that meaning might be is a different issue.86

Earlier, it was stated that where an undefined treaty term does not have a legal or commercial meaning in the state applying the treaty, under Canadian rules of statutory interpretation its meaning will be derived from everyday usage. An example is found in treaty articles based on article 17. Article 17 applies to income derived by an entertainer, such as a theatre, motion picture, radio, or television “artiste.” The word “artiste” is not defined in the OECD model, though its interpretation is discussed in the commentary. The ITA uses the words “artist”87 and “artistic,” but without defining them,88 and not in the context of any provision that imposes tax on non-residents. These words do not have a well-established legal or commercial meaning. The meaning of the term “artiste” was at issue in the Tax Court of Canada case of Cheek v. The Queen,89 which concerned the application of article XVI of the Canada-US tax convention (the equivalent of article 17) to the income of a US resident who was the top radio announcer of the Toronto Blue Jays baseball team. Mogan J decided that the taxpayer was not a radio “artiste,” but a radio journalist. In reaching his decision, Mogan J used the rules of interpretation in the VCLT to determine the meaning of the term “artiste.” He first examined the grammatical function of the term in its immediate treaty context and then determined its ordinary meaning by referring to several dictionary definitions. He concluded that since all the dictionaries he examined defined “artiste” in relation to the performing arts, the taxpayer was not an “artiste” and thus article XVI of the Canada-US tax convention did not apply. Mogan J thought he was supported in his decision by the VCLT, article 17 of the

86 See the discussion below under the heading “What Does the Context Require?”
87 CRA document no. 1999-0009997, March 2, 2000, includes a detailed discussion of the meaning of “artist” and “artiste,” which is essentially identical for both terms.
88 See, however, ITA subsection 10(8), which defines “business that is an individual’s artistic endeavour.”
89 2002 DTC 1283 (TCC).
OECD model, and paragraph 3 of the 1992 commentary on article 17. He did not apply article III(2) of the treaty and did not consider the use of the term “artist” in the ITA, although ITA subparagraph 61(1)(b)(iv) (a provision allowing a deduction for the purchase of an income-averaging annuity contract) uses language that is very close to that of article 17. Even if Mogan J had started by applying article III(2), the “context” exception under that provision would likely have required that the term “artiste” not be given a domestic meaning, because the OECD commentary discusses its interpretation. In any event, it is unlikely that the outcome would have been any different: under Canada’s rules of statutory interpretation, the domestic meaning of the term “artist(e)” would most likely have been based on essentially the same analysis as Mogan J used applying the rules of interpretation in the VCLT.

4. The Term Is Inclusively Defined or Is Subject to a Deeming Provision in the Domestic Tax Law

An undefined treaty term may be inclusively defined in the tax law of the state applying the treaty or, sometimes, it may be subject to a deeming provision. An inclusive, or non-exhaustive, definition is not complete in that it simply specifies a particular meaning to be included in the general meaning of the defined word or phrase. A deeming provision, which technically is not a definition, creates a legal fiction in that it gives a term a meaning that normally cannot be supported linguistically. Deeming provisions are useful in achieving particular legislative purposes, which often may be the prevention of tax avoidance. Both inclusive definitions and deeming provisions implicitly include the general legal, commercial, or ordinary meaning of the term, which must itself be ascertained. In this way, terms that are inclusively defined or that are subject to a deeming rule are similar to undefined terms, and accordingly the discussion immediately above applies to them.

Deeming provisions raise specific issues in determining the domestic meaning of an undefined treaty term, perhaps because they usually provide a meaning that is artificial or even counterintuitive. This is not to say that the domestic meaning of an undefined treaty term derived from a deeming provision may never be used under a treaty article modelled on article 3(2). For example, in The Queen v. Melford Developments Inc., the Supreme Court of Canada decided that deeming provisions in the ITA are applicable for purposes of determining the domestic-law meaning of a term pursuant to a treaty article equivalent to article 3(2). In this case, the taxpayer company, which had borrowed money from a Canadian bank, paid a fee to a German

90 “[T]he individual’s income for the year from the individual’s activities as an athlete, a musician or a public entertainer such as a theatre, motion picture, radio or television artist.”
91 See the discussion below under the heading “The Meaning of ‘Context’ in Article 3(2).” See also Avery Jones, “The ‘One True Meaning’ of a Tax Treaty,” supra note 2, at 221.
92 The use of the word “includes” indicates a non-exhaustive definition.
93 82 DTC 6281 (SCC).
bank for its guarantee of the loan. The minister assessed the taxpayer for the deduction of withholding tax from the payments. The taxpayer was ultimately successful in its appeal against the assessment. At issue was the meaning of the term “interest” in the Canada-Germany tax convention, 1956, which was not defined in that treaty (though it is defined in article 11(3) of the OECD model). The court held that, although the legal meaning of “interest” could not include guarantee fees, such fees were a “payment of interest” pursuant to ITA paragraph 214(15)(a), a deeming provision enacted in 1974 and specifically applicable for withholding tax purposes. However, the court ruled that the undefined treaty term “interest” was to be interpreted under the equivalent of article 3(2) as having the meaning it had under the ITA at the time the convention was adopted.94 According to the Supreme Court, the treaty provisions were not unilaterally altered by the subsequent enactment of the deeming provision; therefore, the guarantee fees in this case were exempt from withholding tax. But for the court’s position on the temporal application of the equivalent of article 3(2), it seems that the court would have applied the additional deemed meaning provided in ITA paragraph 214(15)(a) instead of the legal meaning of “interest” that is generally applicable to the ITA.

Two cases decided by the Supreme Court of the Netherlands on September 5, 200395 are not unlike Melford Developments in that they reached a similar result. These cases concerned the interpretation of the undefined terms “wages,” “derived by,” and “employment” in article 15 of the Netherlands-Belgium tax convention, 1970.96 At issue was the applicability of certain Dutch legislation that deems a taxpayer who performs work for a company of which he is the shareholder to be employed by that company and to have derived each year a certain minimum amount in wages.97 The court, like the Supreme Court in Canada in Melford Developments, refused to apply these deemed meanings for the purposes of the treaty; however, the court’s conclusion on this point was based on a different analysis.98 It held that although article 3(2) of the treaty allowed the Netherlands some flexibility when exercising its taxing rights in situations covered by the convention in accordance with the provisions of

94 This holding was overruled by ITCIA section 3; see supra note 20 and the accompanying text. The current version of article 3(2) of the OECD model is also clear that a dynamic interpretation of undefined treaty terms is required.
95 Hoge Raad, September 5, 2003, BNB 2003/379c* and 381c*.
96 The Convention Between the Government of the Kingdom of the Netherlands and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and for the Settlement of Some Other Questions on Tax Matters, signed at Brussels on October 19, 1970, terminated January 1, 2003.
97 See Engelen, supra note 2, at 491-97. This legislation is designed to prevent individuals from avoiding income taxation and wealth taxation and obtaining social security benefits by forgoing an arm’s-length salary for work performed for a company of which the individual is the shareholder.
its domestic law, the situation before the court was different. The court considered
the intentions of the parties to the treaty and held that the deemed meanings of the
undefined treaty terms at issue could not be used because the Dutch legislation, which
was adopted subsequent to the conclusion of the treaty and which had no equivalent
in the domestic tax law of the other contracting state, resulted in an unjustifiable
shift in the allocation of taxing rights under the treaty. Accordingly, although the
deeming provisions were applicable in determining the Dutch tax liability of non-
residents, the court felt that the context required that the undefined treaty terms
“wages,” “derived by,” and “employment” be given a meaning without regard to the
deeming provisions at issue.

5. The Term Is Not Used in the Domestic Tax Law

An undefined treaty term may not be used in the tax law of the state applying the
treaty; however, this does not mean that article 3(2) is automatically inapplicable
and no reference to domestic law is possible. Two basic scenarios must be distinguished.

On the one hand, the undefined treaty term may not be used in the tax law of the
state applying the treaty, but the term may be well known in that state’s non-tax law.
It may be argued that the private-law meaning of the treaty term cannot be used
because article 3(2) refers to “the meaning that it has . . . under the law of that State
for the purposes of the taxes to which the Convention applies,” which could only be
a meaning that is specific to domestic tax law or a non-tax meaning that is used in
domestic tax law.99 However, such reading would deprive of significance the final
words of article 3(2): “any meaning under the applicable tax laws of that State pre-
vailing over a meaning given to the term under other laws of that State.” Accordingly,
the better view is that it should be possible to ascertain the domestic meaning of an
undefined treaty term by reference to the meaning that it has for the purposes of the
private law of the state applying the treaty, as long as that meaning may be used in
domestic tax law and as long as any tax law meaning is given priority.100

On the other hand, the undefined treaty term may not be used in a state’s domestic
tax or non-tax law, and no term that is equivalent to the treaty term may be known
to that state’s law.101 For example, as discussed earlier, the expression “beneficial
owner” typically is unknown to the tax law and private law of civil-law jurisdictions.
This is a case where the undefined treaty term does not “have” a meaning under the
domestic law for the purposes of the taxes to which the treaty applies. Since in this
instance the reference to domestic law in article 3(2) gives no result, it is not pos-
sible to consider whether “the context otherwise requires.” Therefore, the term is
left to be interpreted directly in accordance with public international law, specifi-
cally, VCLT articles 31 and 32.102

99 See Vogel, supra note 2, at 210. See also Qing Gang Li v. The Queen, 94 DTC 6059 (FCA).
100 See Engelen, supra note 2, at 485-86; and Sasseville, supra note 44, at 375.
101 See Avery Jones et al., supra note 2, at 53-54.
102 Engelen, supra note 2, at 478 and 485; and Vogel supra note 2, at 209-10.
A special case is the situation where an undefined treaty term is not used in domestic tax law but a synonym or some other term to the same effect is so used. An example in the Canadian context is the undefined treaty term “alienation,” which is used with respect to the taxation of gains in treaty articles modelled on article 13. “Alienation” is not used in the ITA, though it does have a meaning in non-tax law. However, the synonymous term “disposition” is used and has a well-established meaning in the ITA.\(^{103}\) Since “disposition” is used in the capital gains provisions of the ITA,\(^ {104}\) it is only logical to apply the tax-law definition of this term for the purposes of article 13, instead of referring to domestic private law to determine the meaning of “alienation.” This was the approach followed by the Federal Court Trial Division in *Gladden Estate*.\(^ {105}\) In this case, the deceased was a resident and citizen of the United States, where he died in 1977 owning shares in two privately controlled Canadian corporations. The minister assessed tax on the deemed disposition of the shares pursuant to ITA paragraph 70(5)(a) and denied the exemption claimed by the estate under article VIII of the Canada-US tax convention, 1942.\(^ {106}\) At the time the convention came into force, the United States taxed capital gains while Canada did not. The exemption referred to “sale or exchange,” words drawn from the US legislation. Holding in favour of the taxpayer, Addy J rejected a literal or legalistic reading of the treaty in favour of a liberal interpretation. The expression “sale or exchange” was found to embrace the “disposition” deemed to have occurred on the taxpayer’s death. This was consistent with the general intention of article VIII of the treaty to exempt non-residents of each country from the country’s capital gains taxes.

Although the Canada-US tax convention, 1942 did not contain an equivalent of article 3(2), *Gladden Estate* shows that this provision would be applicable in this situation and that a liberal interpretation of the word “term” in article 3(2) should cover not only words and expressions but also concepts.\(^ {107}\) This is confirmed by the approach of the US Tax Court in the *Charlotte H. Burghardt Est.* case,\(^ {108}\) which considered the meaning of the undefined treaty expression “specific exemption.” In this case, the estate of a non-resident alien claimed, under the estate tax convention between the United States and Italy, a credit against its estate tax in excess of the credit permitted under the US Internal Revenue Code (IRC).\(^ {109}\) The issue arose because, subsequent to the

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\(^{103}\) See ITA subsection 248(1), which provides a detailed inclusive definition of “disposition.”

\(^{104}\) ITA sections 38-55.

\(^{105}\) Supra note 12.


\(^{108}\) 80 TC 705 (1983); aff’d. without published opinion 734 F. 2d 3 (3d Cir. 1984).

\(^{109}\) Internal Revenue Code of 1954, as amended, section 2102(c)(1).
adoption of the treaty, the IRC had been amended to replace the former exemption with a credit. The US tax authority argued that the expression “specific exemption” referred only to the repealed exemption mechanism. The court held in favour of the estate on the basis that the credit in the domestic tax law was a “specific exemption” as that term was used in the treaty. The court was satisfied that the context of article IV of the treaty permitted it to read “specific exemption” in a broad sense to mean the method by which small estates are exempted from the estate tax. The court also applied the equivalent of article 3(2) in the treaty to support its conclusion.\textsuperscript{110} The judge effectively separated the expression “specific exemption,” which was not used in the IRC, into its constituent words and focused on the domestic meaning of “exemption.” On this basis, the court was of the view that the expression “specific exemption” could refer to the unified credit under the IRC since it was employed in the treaty merely to describe the mechanism whereby small estates are excluded from the scope of the US estate tax.\textsuperscript{111}

Arguably, the court reached the right result, although the judge could have decided the case only on the basis of the non-internal law meaning of the expression “specific exemption” in the treaty.\textsuperscript{112} Yet, this case shows that the notion of “term” in article 3(2) may be given a broad construction to encompass not only words and expressions but also legal concepts.

The article 3(2) analysis in the \textit{Burghardt} case is of special interest where the undefined treaty term is a phrase, such as “specific exemption.” It shows that a court may be tempted to deconstruct a phrase in its search for domestic meaning. Consider, for example, the application of the undefined treaty term “beneficial owner” in a civil-law jurisdiction. On the basis of \textit{Burghardt}, in interpreting “beneficial owner,” a civil-law court may split this expression and focus on the domestic civil-law meaning of “owner.” Arguably, this approach is not correct, but in practice it may be tempting to a court.

\textbf{Implications for the Application of Article 3(2)}

The above discussion suggests two related factors that are relevant to the application of article 3(2). The first relevant factor is the domestic context in which an undefined treaty term is used. Two basic scenarios can be distinguished.

On the one hand, an undefined treaty term may be used domestically in the context of the domestic provision that establishes the tax liability that the treaty restricts. As shown in section 1 above with respect to the term “employment,” since this word is used in the charging provision of the ITA that establishes the taxing right restricted by treaty article 15, it is compelling to use the domestic meaning of the term for the

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\begin{itemize}
  \item \textsuperscript{110} Supra note 108, at 711 (TC).
  \item \textsuperscript{111} Ibid., at 713.
  \item \textsuperscript{112} See Avery Jones et al., supra note 2, at 20-21.
\end{itemize}
purposes of that article. This was essentially the conclusion of the court in Hinkley,¹¹³ for example, and it is consistent with the main purpose of article 3(2), which is to ensure an adequate interface between domestic law and the wording of a tax treaty.

On the other hand, the undefined treaty term may be used domestically in a context other than the context of the domestic provision that establishes the tax liability that the treaty restricts. For example, as noted in section 3 above, the term “beneficial owner” and its variants “beneficial ownership” and “beneficially owned” are used in the ITA, but not in the context of the provisions in part XIII that charge non-residents to tax on Canadian-source dividends, interest, and royalties. As the discussion of Indofood and Prevost Car shows, it is not clear whether the domestic meaning of the undefined treaty term “beneficial owner” should be used for treaty purposes.

On the basis of the distinction between these two scenarios, Engelen has contended that article 3(2) applies only insofar as the undefined term in the treaty is used in a similar context in the relevant provisions of domestic law.¹¹⁴ To my knowledge, there is no Canadian decision that has considered this argument. However, the Supreme Court of the Netherlands dealt with this issue in regard to the meaning of the term “present” as used in article 15(2) of the Netherlands-Brazil tax convention and the Netherlands-Nigeria tax convention.¹¹⁵ The court rejected the application of the equivalent of article 3(2) in those treaties because the term at issue was not used in the domestic tax law of the Netherlands in a context similar to that of treaty article 15(2). The court went on to hold that the term “present” must be interpreted in accordance with VCLT articles 31 and 32. It concluded that “present” as used in the treaties referred to the period of physical presence in the state in which the employment was exercised, rather than the total period of work in that state. Therefore, according to the Netherlands Supreme Court, the equivalent of article 3(2) applies only insofar as the term in question is used in the domestic law of the state applying the treaty in a context similar to the treaty context.

In line with the outcome of this case, Engelen reads into article 3(2) a requirement for the application of this provision that the undefined treaty term be used in the domestic law in a context similar to that of the relevant treaty provision.¹¹⁶ According to Engelen, this is because article 3(2) should not be interpreted literally

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¹¹³ The decisions in Wolf, Kubicek Estate, Melford Developments, and Gladden Estate, discussed above, are to the same effect.

¹¹⁴ Engelen, supra note 2, at 486.


¹¹⁶ Engelen, supra note 2, at 487.
but in good faith.\footnote{Certainly good faith interpretation is mandated by the VCLT; however, the relationship between good faith interpretation and literal reading of a treaty is questionable.} However, it is difficult to see how good faith interpretation leads to the above result.

Arguably, there is nothing in article 3(2) to suggest an unqualified rule that this provision is applicable only where the undefined treaty term is used domestically in the context of the domestic provision that establishes the tax liability that the treaty restricts. The actual wording of article 3(2) does not support the rule adopted by the Netherlands Supreme Court. Article 3(2) provides that an undefined treaty term “shall, unless the context otherwise requires, have the meaning that it has . . . under the law of [the State applying the treaty] for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.” This rule applies irrespective of the context in which the term is used in the domestic law. In light of this wording, first, if the parties to a treaty agreed to include article 3(2) without any changes from the OECD model, it is unreasonable to assume that they intended to restrict its application, as suggested by the Netherlands Supreme Court. The wording of article 3(2) is clear that an undefined treaty term must be given its domestic-law meaning, the only exception being when the context requires otherwise. Second, the final words of article 3(2) are a strong indication that under this provision it is possible to ascertain the domestic meaning of an undefined treaty term directly by reference to the meaning that it has for the purposes of the general law of the state applying the treaty, as long as the term is not used for tax-law purposes. Since such general-law meaning of the undefined treaty term would never be used in the context that is relevant for the treaty provision, the application of article 3(2) may not be limited only to cases where the term in question is used in domestic law in a context similar to that of the treaty provision at issue.

Therefore, the fact that an undefined treaty term is not used in the domestic law in a context similar to that of the treaty does not mean that article 3(2) does not apply. Only in certain cases may this fact indicate that, on a liberal interpretation of the treaty (which is the method recognized by the Supreme Court of Canada), the true intention of the parties to the treaty was that article 3(2) may not apply to a particular undefined treaty term. Such conclusion reached on a case-by-case basis should be exceptional, especially considering the wording of article 3(2), and may not be elevated into an absolute rule. For example, in Cheek, addressing the meaning of the word “artiste” as used in article XVI of the Canada-US tax convention, the Tax Court of Canada seemed to adopt the position that article III(2) of the treaty was not properly applicable.\footnote{See supra note 89 and the accompanying text.} The analysis in Cheek may be explained by the fact that the word “artist” is used infrequently in the ITA and does not have a recognized meaning in the private law of any of Canada’s provinces. Arguably, this approach would not be appropriate with respect to, say, the interpretation of “beneficial ownership,” a term
that is used frequently in the ITA and a well-developed and well-understood concept in common law. In such a case, where article 3(2) is properly applicable, the fact that the undefined treaty term is not used in the domestic law in a context similar to that of the treaty may only be an element suggesting that “the context otherwise requires.”

With respect to the relevance of the domestic context in determining the meaning of an undefined treaty term, an important issue is when an undefined treaty term that is used in domestic law is considered to be used in a context similar to the treaty context. Clearly, this will be the case where an undefined treaty term is used in the domestic charging provision that is restricted by the treaty article at issue. Arguably, an undefined treaty term may also be considered to be used in a domestic-law context similar to the treaty context where it is found in a withholding tax provision associated with the charging provision that the treaty restricts. For example, the term “employer,” which is used in the treaty equivalent of article 15(2)(b), is not used in the provisions of the ITA that charge non-residents to tax on employment income, but is used and exhaustively defined for the purposes of the provision requiring deductions at source on employment income. In this case, the term “employer” arguably is used in a context similar to that of the treaty.

The lengthy discussion of sources of meaning presented above suggests a second and more general factor that is relevant to the application of article 3(2): where article 3(2) is properly applicable, discovering the one most appropriate domestic meaning of an undefined treaty term is a matter of domestic statutory interpretation. This is not a contentious point. For example, it is clearly demonstrated by the decision of the Federal Court of Appeal in Wolf. Commentators agree that whenever the meaning of a treaty term is to be ascertained under the domestic law of the state applying the treaty, it must be interpreted exclusively by domestic methods of interpretation. In fact, if article 3(2) did not allow for domestic rules of interpretation to be used, the reference to domestic law (“the meaning that [the term] has . . . under the law of that State”) would be deprived of its effect. Moreover, the wording of article 3(2) either explicitly or implicitly allows for the use of domestic rules of interpretation to ascertain the domestic meaning of an undefined treaty term. First, it refers to “the” meaning that the undefined treaty term has under the law of the state applying the treaty. Of course, where the treaty term has more than one meaning in domestic law, finding “the” meaning for the purposes of article 3(2) requires a choice at the internal-law level between such meanings. This is a matter of domestic interpretation. Second, article 3(2) states that the meaning of the undefined treaty

119 ITA section 153 and regulation 100(1).

term that must be used is the meaning “under the law” of the state applying the treaty. Arguably, “law”\textsuperscript{121} denotes the entire body of law that relates to the taxes to which a treaty applies, including the general law underlying the fiscal legislation, case law, and relevant rules of interpretation.\textsuperscript{122}

The relevance of the above two factors will be considered next in dealing with the issue of how domestic rules of interpretation are properly to be applied when ascertaining the domestic meaning of an undefined treaty term.

**Application of Domestic Rules of Interpretation**

**In General**

Article 3(2) is a peculiar provision in that it directs that an undefined treaty term be “extracted” from its natural context within a tax treaty and instead be given its domestic legal meaning in the state applying the treaty. The most appropriate domestic meaning of the undefined treaty term for the purposes of article 3(2) is ascertained pursuant to the domestic rules of interpretation in the state applying the treaty. However, domestic systems of interpretation applicable to tax statutes may vary widely from state to state.\textsuperscript{123}

The Supreme Court of Canada recently stated in *The Queen v. Canada Trustco Mortgage Co.*:

> It has been long established as a matter of statutory interpretation that “the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.” . . . The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process.

\textsuperscript{121} In versions of the OECD model prior to 1977, the reference was to “laws.”

\textsuperscript{122} Sasseville, supra note 44, at 375. This argument appears to be supported by the French text of the OECD model, which since 1977 has referred to droit (law) instead of législation (statute law). Contra Vogel, supra note 2, at 210.

On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.\(^{124}\)

Interpretation properly begins with reading words of the tax statute in their grammatical and ordinary sense.\(^{125}\) This is the meaning actually understood by a reader upon considering a word or expression in its immediate context. Typically, judges derive this meaning from dictionaries. However, words must be interpreted in relation to the broader context in which they are used.\(^{126}\) Generally, a distinction may be drawn between literary, legal, and external categories of context. The literary context includes the immediate context of the words being interpreted, the particular statute in which they are found read as a whole, and the entire body of legislation enacted by the legislature. The legal context consists of the body of substantive law that may be referred to for the purpose of inferring legislative intent, such as statutes, case law, and the common law (including civil codes). External context refers to the setting in which the law was enacted (for example, the mischief that the particular tax statute attempts to remedy) and the setting in which it currently operates. Finally, purposive analysis takes into account the material goals that the legislature hoped to achieve and the reason behind each feature of the implementing legal text.\(^{127}\) Generally, provisions of domestic tax legislation are designed to reflect the principal objectives of an income tax system, namely: raising revenue, promoting equity between taxpayers, being neutral, and facilitating the administration of the system.\(^{128}\) The majority of the provisions of a tax statute can be classified into the following groups in accordance with their purposes: charging provisions that create tax liability; tax expenditure provisions that provide subsidies for policy reasons; anti-avoidance provisions that are designed to preserve the integrity of the charging provisions and tax expenditure provisions; and administrative provisions.

In light of this, the issue is how a domestic system of statutory interpretation, such as Canada’s, that uses a textual, contextual, and purposive analysis may sensibly be applied when ascertaining the domestic meaning of an undefined treaty term under article 3(2). This section considers this question at two levels: first, in terms of the determination of the domestic legal meaning(s) of the undefined treaty term; and second, in terms of the choice between several domestic meanings of a treaty term. It is argued that the one most appropriate domestic meaning of an undefined treaty term must always be ascertained by reference to the relevant domestic charging provision in its domestic context and in light of its domestic purpose.

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\(^{124}\) 2005 DTC 5523, at paragraph 10 (SCC).

\(^{125}\) Sullivan and Driedger, supra note 3, at chapter 2.

\(^{126}\) Ibid., at chapter 10.

\(^{127}\) Ibid., at chapter 8. See generally Barak, supra note 3.

Determining a Domestic Legal Meaning of an Undefined Treaty Term

The difficulty with using a textual, contextual, and purposive interpretation in determining the domestic meaning of an undefined treaty term is that it may not always be clear what the context should include and what the relevant purpose is. Although it is the meaning of a treaty term that is being sought under article 3(2), in determining domestic meaning, interpretation should not refer to the context and purpose of the relevant treaty. The wording of article 3(2) is unambiguous that the meaning “under the law of that State for the purposes of the taxes to which the Convention applies” must be used, unless the context otherwise requires. Moreover, it is clear that domestic rules of interpretation should not be used in international law to interpret the treaty itself. Therefore, where article 3(2) is properly applicable, the undefined treaty term should be interpreted only in light of the relevant domestic context and purpose, without any regard to the treaty.

This approach is compelling when the undefined treaty term is used in the context of the domestic taxing provision that is restricted by the tax treaty. It yields the proper result in that the scope of the treaty relief provision would be the same as the scope of the charging provision in the tax law of the state applying the treaty. This coordination between domestic law and a treaty is shown clearly in the Wolf decision. As discussed earlier, in this case, the Federal Court of Appeal was asked to determine whether the taxpayer was engaged in “independent personal services” or “dependent personal services” for the purposes of articles XIV and XV, respectively, of the Canada-US tax convention. If the taxpayer was an employee, he was taxable in Canada under article XV of the treaty and could not deduct the various business expenses he claimed. If, on the other hand, he was providing independent personal services, he was not taxable in Canada under article XIV, since it was conceded that he did not have a fixed base in Canada. One outcome was more favourable to the appellant than the other. In a situation like this, conceivably a taxpayer may seek to manipulate the outcome, and such attempts may be seen as abusive of the treaty. Thus, it appears that for treaty purposes it is important to observe the distinction between “independent personal services” and “dependent personal services” based in essence on the economic substance of the relationship between the parties. However, this is equally the case under the ITA: a taxpayer earning income from “independent personal services” (that is, business income) is typically treated more favourably than a taxpayer earning employment income. Thus, for purely domestic tax purposes, it is not unusual for employees to attempt to represent themselves as independent contractors.

129 See Avery Jones et al., supra note 2, at 24; Vogel, supra note 2, at 34 and 209; and International Fiscal Association, supra note 120, at 15.

130 See Hogg et al., supra note 128, at chapter 5. The most important advantages of being treated as an independent contractor for the purposes of the ITA are not having any tax withheld from pay at source and being able to deduct a broad category of business expenses, in contrast to the few expenses specifically permitted for employees.
Understandably, Canadian tax jurisprudence is replete with cases that essentially adopt a purposive interpretation of the ITA to distinguish employees from independent contractors.\textsuperscript{131} In this respect, courts are motivated by the desire to respect the intention of the legislation to tax employees and independent contractors differently because they are in different economic circumstances. In light of this, \textit{Wolf} shows that there is commonality of context and purpose between the treaty and the ITA with respect to the interpretation of and distinction between the notions of independent personal services and employment.

The textual, contextual, and purposive analysis required in interpreting an undefined treaty term under the ITA, however, does not seem to allow the domestic interpretation of the term to accommodate any purposes that are specific to the treaty. For example, this appears to be the case in respect of “international hiring-out of labour.” The \textit{OECD} describes hiring-out as a system under which a local employer wishing to employ foreign labour for one or more periods of less than 183 days recruits through an intermediary established abroad who purports to be the employer and hires the labour out to the employer.\textsuperscript{132} The effect of this arrangement is that the employee is not taxed in the source state under the \textit{OECD} model; for the purposes of article 15(2)(b), the remuneration will be paid by an “employer” (an undefined treaty term) who is not resident in the source state. The \textit{OECD} considers this type of transaction to be abusive.

The word “employer” is used frequently in the ITA. It also has a well-established meaning in non-tax law. Although “employer” is not used in the provisions of the ITA charging non-residents to tax on employment income, arguably it is used in a context similar to that of the treaty since it is exhaustively defined to mean “any person paying remuneration” for the purposes of the provision requiring withholding at source on employment income.\textsuperscript{133} The issue is whether domestic interpretation of the undefined treaty term “employer” in this context would be able to prevent alleged treaty abuse in an international hiring-out situation.

The \textit{Hinkley} case seems to suggest a negative answer to this question.\textsuperscript{134} In \textit{Hinkley}, the court decided that in a situation involving an employment agency, the employment relationship is between the agency and the worker and not between the agency’s


\textsuperscript{132} Paragraph 8 of the commentary on article 15 of the \textit{OECD} model.

\textsuperscript{133} ITA section 153 and regulation 100(1).

\textsuperscript{134} Sasseville, supra note 44, at 376. See also \textit{Wolf}, supra note 48, at paragraph 77; but note that the FCA found that the taxpayer was an independent contractor in respect of the client of the consulting firm and not the consulting firm itself.
determining domestic meaning under article 3(2) of the oecd model

client and the worker. It must be noted that the decision in Hinkley is not exactly on point since the issue was the distinction between employment and independent personal services and not whether the client of the employment agency could be the “employer” of the taxpayer. Moreover, the employment agency in this case was a resident of Canada, and therefore this was a situation of “national” rather than “international” hiring-out of labour. Nonetheless, it is arguable that the outcome in Hinkley would not have been different if the case had involved an international hiring-out arrangement. The ITA is indifferent to the identity of the employer when taxing employment income, as shown by the fact that ITA section 5 does not even use the word “employer.” This is because in purely domestic situations, hiring-out does not raise any policy concerns under the ITA. Thus, it seems unlikely that a court would interpret the term “employer” to mean the client of an employment agency on the basis of the economic substance of the relationship. Therefore, domestic interpretation may be unable to meet any policy concerns that are specific to the treaty. This outcome may explain the approach to interpreting the undefined treaty term “employer” in international hiring-out situations suggested by the OECD:

To prevent such abuse, in situations of this type, the term “employer” should be interpreted in the context of paragraph 2 [of article 15]. In this respect, it should be noted that the term “employer” is not defined in the Convention but it is understood that the employer is the person having rights on the work produced and bearing the relative responsibility and risks.

In cases of international hiring-out of labour, these functions are to a large extent exercised by the user. In this context, substance should prevail over form, i.e. each case should be examined to see whether the functions of employer were exercised mainly by the intermediary or by the user.135

As pointed out above, the undefined treaty term sometimes may not be used in the context of the domestic taxing provision that is restricted by the treaty; for example, the concept of beneficial ownership is not used in the charging provisions for non-resident taxation in part XIII of the ITA (section 212). Yet, in determining the domestic meaning of this term under article 3(2), “beneficial ownership” may reasonably be interpreted only in the context and in light of the purpose of section 212. It would be meaningless to do otherwise. Since the ITA does not provide a special meaning for “beneficial ownership” and since section 212 does not use this concept, there is a strong presumption that no special meaning that is different from the general private-law meaning of this term should be used. On this basis, as suggested by the High Court decision in Indofood, domestic interpretation of the undefined treaty concept of beneficial ownership would be inadequate to deal with situations that the OECD may perceive as abusive for tax treaty purposes.

135 Paragraph 8 of the commentary on article 15 of the OECD model (emphasis added).
Choosing Between Several Domestic Meanings of an Undefined Treaty Term

The domestic tax law of the state applying the treaty may contain multiple meanings for an undefined treaty term. This is not unusual, since tax laws are complex legal instruments and different sections of the domestic tax law may require different meanings of the same word. Such meanings may be derived from a combination of the general legal meaning of the term, exhaustive definitions, inclusive definitions, and deeming provisions. In a purely domestic situation, no choice is necessary because a particular statutory provision would use only one of these meanings. However, under article 3(2), the situation is different: where there are several meanings of a single term under domestic law, it is necessary to choose the most appropriate one.136

Generally, where a choice between several domestic meanings of an undefined treaty term is required, the meaning that the term in question has for the purpose of the provision imposing the tax on the item of income or capital concerned is to prevail.137 Engelen argues that this is logical because the law imposing the tax that is actually at issue is part of the context in which the term in question should be interpreted and applied in accordance with article 3(2).138 This is definitely so when the undefined treaty term is used with one meaning in the charging provision at issue and with a different meaning in some other provision of the domestic tax law. The logical choice is less clear when the undefined treaty term is used and has different meanings either in two or more relevant charging provisions or in two or more provisions that are not relevant to the charge that the treaty restricts.

The first scenario may occur where a contracting state levies a withholding tax and an income tax at the same time, both of which are covered by the treaty, and a term used in the treaty is defined differently for the purposes of the different charges to tax. In these cases, Engelen, in my view, correctly argues that the meaning that the term in question has under the law imposing the income tax ultimately due prevails over the meaning it has under the law imposing the withholding tax, assuming that the withholding tax is merely an advance payment and may be credited fully against the final income tax.139 This was the conclusion of the Supreme Court of the Netherlands in a case involving a Dutch company that bought back its shares from a Belgium-resident individual.140 Under the Dutch Income Tax Act, 1964, the difference between the proceeds of sale and the cost base of the shares was treated as

136 Avery Jones et al., supra note 2, at 22.
137 See United States, Treasury Department, “Technical Explanation of the United States Model Income Tax Convention (September 20, 1996),” article 3: “Finally, there also may be cases where the tax laws of a State contain multiple definitions of the same term. In such a case, the definition used for purposes of the particular provision at issue, if any, should be used.”
138 Engelen, supra note 2, at 487.
139 Ibid.
140 Hoge Raad, December 12, 2003, case no. 38,461.
a capital gain, whereas the Dutch Dividend Withholding Tax Act, 1965 provided that the difference between the selling price and the average paid-up capital of the shares was a dividend. Under Dutch law, the dividend withholding tax could be fully credited against the income tax due in respect of the capital gain. The court decided that for the purposes of the Netherlands-Belgium tax convention, the income derived from the share buyback should be treated as a capital gain and not as a dividend. Accordingly, the income was exempt from Dutch tax pursuant to article 13(4) of the treaty.

The second scenario, which involves a choice between two or more meanings applicable to provisions that are not relevant to the charge that the treaty restricts, raises the most difficult issues. I am not aware of any authorities that have discussed this situation. Arguably, the choice between different domestic meanings should always be made by reference to the domestic charging provision at issue in its domestic context and in light of its domestic purpose. Where this provision does not contain the undefined treaty term, it must be assumed that the legislator has deemed it unnecessary or superfluous to use it, much less to provide a special meaning for it. This is because the particular treaty term would likely add nothing to the achievement of the purpose of the particular charging provision. In light of this, where the undefined treaty term is not used in the domestic law in the same context as in the treaty, in choosing between different domestic meanings, arguably there should be a strong preference for a meaning of the term that is applicable to the entire tax statute. Conversely, specific meanings in the tax statute that are irrelevant to the charge that is subject to the treaty, which normally aim at particular policy objectives, should be rejected, because it is unlikely that they would ever be used for the purposes of the charging provision at issue. Moreover, it is very likely that such meanings would be ousted under the “context” exception in article 3(2)—that is, in these circumstances, there is a strong probability that the context would require recourse to a meaning other than the meaning under domestic law.

“UNLESS THE CONTEXT OTHERWISE REQUIRES”

The main focus of this article has been the determination of the meaning in domestic law of an undefined treaty term pursuant to article 3(2). However, an analysis of article 3(2) would be deficient without at least a brief consideration of the exception to the reference to domestic law—namely, “unless the context otherwise requires.” The application of this exception has been the core concern of the great majority of studies dealing with article 3(2). The following discussion does not attempt to provide an exhaustive analysis of the “context” exception; rather, it aims at integrating the reference to domestic law within the general scheme of article 3(2). Specifically,

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141 Avery Jones et al., supra note 2, at 22-24, provides examples that suggest that tax authorities avoid dealing with these issues explicitly.

142 See de Broe et al., supra note 131, at 507.

143 See generally those referred to in note 2, supra.
it seems clear that, technically, the question of whether “the context otherwise requires” may not be tackled before the most appropriate domestic meaning for the undefined treaty term has been found. According to the discussion in the core section of this article, it provides insight into when the context might require the use of a meaning other than the domestic meaning.

The Meaning of “Context” in Article 3(2)

What is meant by “context” is one of the recurring questions in the debate surrounding article 3(2). The word “context” is not defined in the OECD model. Although “context” is certainly a term of law, it is not found in tax jargon. Conceivably, “context” may be given a meaning under the law of the state applying the treaty; however, it cannot be desirable that such a fundamental term of a tax treaty may have different meanings, depending on which state is applying the treaty. Accordingly, “context” for the purposes of article 3(2) should be a term of general tax treaty law.

Arguably, the correct approach is that “context” should be construed broadly to include “all of the items which may be taken into account, or to which one may have recourse, in interpreting treaties generally.” Specifically, on the basis of the discussion in the core section of this article, it is reasonable that “context” should include all of the elements that have been taken into consideration in determining the domestic meaning of the treaty term for the purposes of article 3(2).

When Does the Context Require Otherwise?

There is little doubt that “requires” is a word of some force. Arguably, the use of this word shows that article 3(2) is different from the rules in the VCLT in that, a priori, it establishes a preference for domestic interpretation.

Whether the context requires otherwise, however, is a matter of degree: “not every apparently convincing interpretation from the context should give rise to a divergence from the rule of Art. 3 (2), but only those based on relatively strong arguments.” Thus, whether the context suggests an alternative interpretation that is sufficiently persuasive to overthrow the domestic meaning of the treaty term at issue is a matter that can be decided only on its facts in relation to each individual case. There are a variety of elements in the process of determining the most appropriate domestic meaning of an undefined treaty term, which might point in one 

144 See Vogel, supra note 2, at 213-14. In practice, the treaty context is likely to inform the determination of the domestic meaning of the undefined treaty term.
145 See van der Bruggen, supra note 2, at 143-44.
146 The ambit of the concept, however, remains open to discussion: ibid.
147 Avery Jones et al., supra note 2, at 104. See also Vogel, supra note 2, at 215.
148 Avery Jones et al., supra note 2, at 108.
149 Vogel, supra note 2, at 214 (emphasis added).
150 Avery Jones et al., supra note 2, at 108.
or another direction with respect to whether the context requires otherwise.\textsuperscript{151} As noted above, where the undefined treaty term is used in the tax law of the state applying the treaty, in the same context as the treaty context, and the tax meaning is well established, it seems unlikely that the context would be sufficiently strong to require that this domestic meaning be ousted. It has been suggested that this might be the case for the term “employment” in relation to its use in the ITA. Arguably, only a very strong contextual element, such as another meaning that has been specifically agreed between the contracting states, would require that this domestic meaning be ousted.

On the other hand, where the undefined treaty term is used in the tax law of the state applying the treaty in a context that is very different from that of the treaty, the context of the treaty may well be sufficiently distinct to require that some other interpretation be used. It has been suggested that this may be the case for the term “beneficial owner” in relation to its use in the ITA.

**What Does the Context Require?**

Arguably, the context may require that the domestic meaning of an undefined treaty term not be used because it is clearly inappropriate for the purposes of the treaty, or it may suggest that a specific other meaning be used because it is much more suitable for the purposes of the treaty. In the former case, it may be difficult to decide what alternative meaning should be used. In this respect, a different domestic meaning, whether in the law of the state applying the treaty or in the law of its treaty partner, would usually be a plausible option.\textsuperscript{152}

For instance, with respect to the undefined treaty expression “beneficial owner,” it is arguable that this term should be given a tax-treaty meaning that is independent of the tax law of a particular state.\textsuperscript{153} However, there does not seem to be any agreement on what meaning should be used instead.\textsuperscript{154} One option is that the domestic-law meaning of “beneficial owner” in common-law countries be imported into the OECD model as a universal meaning.\textsuperscript{155} Another option is that “beneficial owner” be given an independent treaty meaning that is consistent with the OECD’s views on the subject.\textsuperscript{156} Recent cases that have grappled with the issue show the divergence in opinion.

\textsuperscript{151} See generally the examples discussed in the core section of this article.

\textsuperscript{152} See paragraph 12 of the commentary on article 3 of the OECD model. See also Vogel, supra note 2, at 215.


\textsuperscript{154} Oliver et al., supra note 153, at 318ff.

\textsuperscript{155} Ibid.

\textsuperscript{156} Paragraph 12ff. of the commentary on article 10 of the OECD model.
On the one hand, the High Court decision in *Indofood*\(^{157}\) seems to show that the English common-law concept of beneficial owner could be used for treaty purposes, either under an application of the main rule in article 3(2) or because the “context” required otherwise. On the other hand, the Court of Appeal decision in this case interpreted this expression broadly and purposefully in light of the approach suggested by the OECD.

Two other recent decisions of courts in civil-law jurisdictions seem to have preferred a narrower approach to the concept of beneficial ownership that is more consistent with its common-law meaning. In a French case, *Bank of Scotland*, the Court of Appeals of Paris interpreted the expression “beneficial owner” in the France-UK tax convention with respect to a usufruct of shares.\(^{158}\) In this case, the Bank of Scotland, a UK resident, purchased for three years preferred non-voting shares in a French company from its US parent, Merrell Dow Pharmaceuticals Inc. The amount of the dividend to be distributed on that preferred stock was determined at the time of the purchase and the acquisition price was equal to the predetermined amount of dividends. The French tax authority argued that the Bank of Scotland was not the “beneficial owner” of the dividends and therefore could not claim the reduced withholding rate under the treaty and the avoir fiscal attached to such dividends. The court disagreed and held in favour of the taxpayer. It construed the term “beneficial owner” to embrace an agent, a nominee, or an artificially interposed conduit. It is notable that the court did not refer to the commentary on the OECD model regarding the meaning of “beneficial ownership.”\(^{159}\)

Similarly, in a Swiss case, *A Holding Aps v. Federal Tax Administration*, the Federal Court considered whether, in a treaty-shopping situation, the taxpayer—a Danish-resident company—was the “beneficial owner” of dividends paid by a Swiss company for the purposes of the Switzerland-Denmark tax convention.\(^{160}\) In this case, the Danish company was a wholly owned subsidiary of a Guernsey company, which in turn was wholly owned by a company incorporated in Bermuda. The Danish company was found to be the “beneficial owner” of the dividend from the Swiss company, notwithstanding that it had no staff, offices, or other assets and that, upon receipt

\(^{157}\) See supra note 71 and the accompanying text.


\(^{159}\) See paragraph 12.1 of the commentary on article 10 of the OECD model.

\(^{160}\) 2A.239/2005/bie (November 28, 2005). See the Convention Between the Swiss Confederation and the Kingdom of Denmark for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, signed at Bern on November 23, 1973, as amended by the protocol signed on March 11, 1997.
of the dividend, it immediately paid the entire proceeds to its Guernsey parent. Nonetheless, the claim for a reduction in withholding tax was denied, since the court held that the tax treaty was abused.

CONCLUSION

Article 3(2) is a special rule of tax treaty interpretation that takes precedence over the general rules set out in the VCLT. Article 3(2) essentially shifts the issue of interpretation of undefined treaty terms to the domestic level.

This article has examined several situations that involve the interpretation of an undefined treaty term in light of its domestic use and meaning(s). The discussion has suggested two related factors that are relevant to the application of article 3(2). First, it is important to consider whether the undefined treaty term is used in domestic law in the context of the provision that establishes the tax liability that the treaty restricts. Second, where article 3(2) is properly applicable, discovering the one most appropriate meaning of an undefined treaty term is a matter of domestic statutory interpretation.

The article has considered the relevance and interaction of these two factors in dealing with the issue of how a domestic system of statutory interpretation, such as Canada’s, that uses a textual, contextual, and purposive analysis, may sensibly be applied when ascertaining the domestic meaning of an undefined treaty term under article 3(2). This question has been analyzed at two levels: first, with respect to the determination of each domestic meaning of the undefined treaty term; and second, with respect to the choice between different domestic meanings of a treaty term. It has been argued that, whether or not the undefined treaty term is used in domestic law in the same context as in the treaty, the most appropriate domestic meaning for the purposes of article 3(2) must be ascertained by reference to the relevant domestic charging provision in its domestic context and in light of its domestic purpose, without regard to the treaty. Where the undefined treaty term has a meaning for the purposes of the provision imposing the tax that is restricted by the treaty, that meaning must be used for the purposes of article 3(2). Where the undefined treaty term is not used in domestic law in the same context as in the treaty, however, there should be a strong preference for a meaning of the term that is applicable to the entire tax statute. Generally, this approach ensures proper coordination between the treaty and domestic law. However, this article has argued that a textual, contextual, and purposive interpretation may not allow the domestic meaning of an undefined treaty term to be determined by policy objectives that are specific only to the treaty.

Finally, all elements that are relevant in determining the domestic meaning of an undefined treaty term should be considered as part of the “context” under article 3(2) to determine whether the context requires that an alternative interpretation be used. Since “requires” is a word of some force, only a relatively convincing alternative interpretation would be able to displace the domestic meaning of an undefined treaty term. Thus, it has been argued that the general rule of tax treaty interpretation in article 3(2) is different from the VCLT in that, a priori, it establishes a preference for domestic interpretation in determining the meaning of undefined terms.