CANADIAN TAX Highlights

Editor: Vivien Morgan, LL.B.

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Revenue on DRUPA

Effective January 1, 2000, Delaware adopted a new general partnership statute—the Delaware Revised Uniform Partnership Act (DRUPA). (See "Delaware Adopts RUPA," *Canadian Tax Highlights*, January 25, 2000, at 4.) Revenue recently issued a technical interpretation (TI) concluding that a DRUPA partnership is a corporation under Canadian tax law, whether or not it avails itself of the option to elect out of entity status for certain purposes.

The TI cites IT-343R, "Meaning of the Term Corporation," which states that a "corporation is an entity created by law having a legal personality and existence separate and distinct from the personality and existence of those who caused its creation or those who own it." Revenue says that the definition of "corporation" in the federal Interpretation Act, which states that a "corporation does not include a partnership that is considered a separate legal entity under provincial law," does not apply to a partnership created under US state law. Revenue says that its conclusion about DRUPA partnerships is based on its reading of certain DRUPA provisions that are included in an appendix to the TI. The appendix includes provisions to the effect that property acquired by the partnership is not property of the partners, that a partnership may sue and be sued in the name of the partnership, and that a judgment against the partnership is not by itself a judgment against a partner. Even though DRUPA contains an election to opt out of entity treatment, Revenue concludes that such an election does not render a DRUPA partnership a partnership for Canadian tax purposes, in particular because of a non-waivable provision that states that "the partnership agreement may not . . . restrict rights of third parties . . . without the consent of those third parties." However, Revenue does leave the door open to further consideration of this issue. One wonders whether opting out of separate entity status would restrict or merely affect and perhaps even enhance third-party rights.

However technically sound Revenue's position may be, it creates a myriad of practical problems, given that Delaware is the preferred jurisdiction for entity formation in the United States. Revenue's position implies that a partnership for Canadian tax purposes cannot exist in Delaware. But the issue is of even broader import because many other US states have also adopted the uniform act, and more are slated to do so; Delaware may be the only participating state with legislation that contains an opting-out clause. Furthermore, similar provisions establishing separate entity status are included in many states' limited partnership statutes. Thus it is hoped that Finance will consider legislative action to avoid potential disruptions to ordinary business practice involving the use of US partnerships.

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In This Issue

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Harris: Still on the Rails

The action in *Harris*, brought on behalf of all taxpayers in an attempt to force the minister of national revenue to reverse alleged preferential treatment given to a particular taxpayer, has been allowed to proceed by the FCA. A case that some skeptics initially viewed as frivolous now appears to be gaining some momentum. Barring a further appeal to the SCC, the ball has now landed in the FCTD: the decision of that court will be of great interest to taxpayers and tax practitioners alike.

In 1985, Revenue issued an advance tax ruling to a trust, stating that the trust's public company shares were not deemed disposed of when they were distributed to a non-resident trust. In 1991, the law firm that represented a related trust requested a similar ruling. Again a favourable ruling was issued, but Revenue reserved a 10-year right to reverse itself and reassess. Neither ruling was published, although after the 1985 ruling Revenue published a ruling that was issued to another taxpayer and that took a directly contrary position.

The auditor general (AG) issued a strongly worded report criticizing both the correctness of the 1991 ruling and the "seeming covertness in which the ruling was made." The AG also suggested that the access of the taxpayers in the 1991 ruling to the unpublished 1985 ruling may have allowed them to enjoy advantages not available to other taxpayers. After unsuccessfully requesting that the attorney general refer the rulings to a court for assessment of their correctness and propriety, Mr. Harris commenced an action seeking a declaration that the minister is obliged to use all available measures to assess and collect tax properly due and owing as a result of the transaction referred to in the 1991 ruling. The attorney general brought a motion to strike the statement of claim on the grounds that it disclosed no reasonable cause of action and that Mr. Harris did not have standing to bring the action. Mr. Harris prevailed on appeals to the FCTD and FCA.

The FCA said that a motion to strike a statement of claim should only be granted if it is plain and obvious that the case will not succeed, a conclusion that it could not reach in light of conflicting Canadian and British jurisprudence as to whether tax authorities owe a fiduciary duty to taxpayers at large and even though the Crown might have strong arguments. On the issue of standing, if Mr. Harris were simply questioning the underassessment of another taxpayer, case law indicated a strong public interest in striking his statement of claim. In fact, Mr. Harris alleged maladministration and ulterior motives of persons who owed a public duty to assess in accordance with the law. For over two months after receipt of the 1991 ruling request, Revenue officials allegedly concluded repeatedly that a favourable ruling could not be issued and intended to recommend GAAR's application to the GAAR Committee. Justice issued a draft opinion that the technical issue was ambiguous but that the scheme of the Act dictated denial of the ruling request. However, a series of meetings between Finance and Revenue officials—meetings for which no minutes were kept—resulted in the ruling's issue. Subsequently, a favourable opinion was given by Justice. The FCA noted that the minister may not enter into compromise settlements, and in fact any agreement to assess otherwise than in accordance with the law is an illegal agreement. There was a serious and justiciable issue in which the taxpayer had an interest and no other reasonable and effective manner to bring the issue before the court. The court recognized the strong public interest in allowing the challenge to the minister's alleged failure to properly apply the law: there is no prospect that the beneficiary of alleged favouritism will challenge the minister.

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Offshore Fishing

June 22, 2000 draft legislation deals with the taxation of non-resident trusts and foreign investment entities. The draft also expands the range of taxpayers required to file with Revenue an annual information return reporting transfers or loans to non-resident trusts. The proposed reporting extends beyond situations in which the non-resident trust is clearly subject to tax under the proposals.

Under the existing rules, reporting is required by a person who transfers or loans property to certain kinds of foreign trusts that have a Canadian-resident beneficiary. Proposed reporting is generally required for taxation years beginning after 2000 for a Canadian resident who makes a "contribution" to a non-resident trust or a "similar arrangement" at or before the end of the year. The return is made in respect of the non-resident trust's particular taxation year and is due by the filing due date for the contributor's year in which that trust taxation year ends. Subject to certain conditions, the proposals impose reporting on loans or transfers that are not to trusts but to similar arrangements: transfers or loans of property to be held under an arrangement governed by foreign laws or to be held by a non-resident entity as defined.

A non-resident entity is defined to include a corporation or trust that is non-resident at that time and any entity (other than a corporation or trust) organized or governed under foreign laws. A person must file an information return with respect to a loan or transfer made either under an arrangement governed by foreign laws or to a non-resident entity that is not an exempt (foreign) trust and is not otherwise the subject of reporting under these rules, if two other conditions are met: the transfer or loan was not an arm's-length transfer and was not solely in exchange for certain types of foreign property such as a share of capital stock of a foreign company, indebtedness of a non-resident person, and tangible property situated outside Canada. In such a case, the related reporting obligations of the person who made the transfer or loan are determined as if the transfer was a contribution to which the non-resident reporting rules applied, the entity or arrangement was a trust not resident in Canada, and the taxation year of the entity or arrangement was the calendar year.

According to Finance's explanatory notes, one of the key objectives in casting the reporting net so wide is to allow Revenue to review other arrangements and arrangements similar to contributions to trusts in order to assess whether the taxpayer falls outside the non-resident trust rules. Information provided in the reporting process will also give a window on tax-planning arrangements designed to sidestep the new rules and highlight areas in which recommendations should be made to Finance to amend the rules. These sweeping reporting obligations no doubt will catch many taxpayers unaware and cause a chill in tax-planning activities involving investments in non-resident trusts and similar arrangements.

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More Green Book Gems

Revenue's Web site has a table showing payments of the federal child tax benefit paid on the basis of 1997 taxable income. The payments, actually made in the period from July 1998 to June 1999, totalled $5.5 billion, of which 70 percent went to children in families with 1997 incomes less than $30,000. But the table shows that payments were made to families with much higher incomes.

1998-99 Child Tax Benefits (Based on 1997 Tax Year)

Net family income	*Average annual benefit per child ($)*	*Percentage distribution*	*Minimum benefit under allowance & tax credit ($)*
Under $25,921	1,568	63.2	432
$25,921 to 30,000	1,057	6.3	432
$30,000 to 40,000	901	12.8	371
$40,000 to 50,000	677	9.1	371
$50,000 to 60,000	449	5.5	371
$60,000 to 70,000	324	2.2	350
$70,000 to 80,000	338	0.7	350
$80,000 to 90,000	226	0.2	350
$90,000 to 100,000	288	0.1	350
$100,000 and over	278	0.0	350
Average	1,041	100.0*	398

* Difference due to rounding.

In total, 3.2 million families received benefits—about 62 percent of all families with children still at home. Before 1993, the child tax benefit was smaller, family allowances were available to families with incomes of less than about $50,000 per year, and even high-income families could take advantage of the non-refundable tax credit (previously an exemption) under the personal income tax system. The system that took effect after 1992 diverted federal resources from the two discontinued programs to the child tax benefit, providing more assistance to lower income levels at the expense of families with above-average incomes.

The table shows that those at the bottom of the income scale received $1,568 per year ($131 per month) for each child, compared with a benefit under the old family allowance and tax credit system of $432 per year. Some families with incomes near the national average of $66,000 in 1997 qualified for and received only slightly less under the new system ($324 per child annually) than they would have under the old system ($350). Only about 1 percent of all benefits under the new system were paid to families at or above the national average income.

Although the child tax benefit revisions of 1993 directed federal assistance where it was most needed, they failed to take account of the burdens of child raising for those with above-average incomes. As tax reductions and tax reform become topics of public debate, this issue becomes more important. The directions outlined in recent federal budgets, however, make it clear that the base concept in the new system—focusing on income-related programs—will remain the primary method of assisting families with children.

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EU VAT on E-Services

In a bold if somewhat controversial move, the European Commission has proposed modification of its VAT rules applicable to the supply of electronic services in order to level the playing field of taxation on such services and to simplify compliance as much as possible.

It is a fundamental VAT principle that only supplies consumed within a taxing jurisdiction should be taxed there. However, services delivered electronically are currently subject to VAT if they originate in the EU, regardless of where consumption occurs. Conversely, such services originating outside the EU are not subject to VAT. This anomaly creates competitive distortions and a perceived bias in favour of non-EU service providers. To correct these deficiencies, the proposals tax electronically delivered services if and only if they are consumed in the EU, regardless of the jurisdiction of origination. To ensure that VAT is appropriately collected on such services, a non-EU vendor must register for VAT purposes if its annual business-to-consumer sales in the EU exceed €100,000. An EU business supplying digitized services to purchasers for consumption outside the EU need not charge VAT. Business-to-business sales are excluded from the new mandatory registration and collection of VAT: the existing VAT, in a manner similar to GST, incorporates self-assessment for certain business purchasers. The proposals are directed toward supplies delivered by electronic means, such as the digital delivery of computer software and related services. Information, cultural, artistic, sporting, scientific, educational, entertainment, and similar services are also encompassed.

Criticism of the proposals centres on certain definitional complexities, the practicality of forcing non-EU vendors to register, and the timing of the announcement. The EU is said to be anxious to address the issues before e-commerce becomes a much greater component of the EU economy and before EU businesses suffer greater market disadvantage. It remains to be seen whether the EU's choice to move quickly is the course of wisdom: the OECD is not slated to conclude its own review until 2001.

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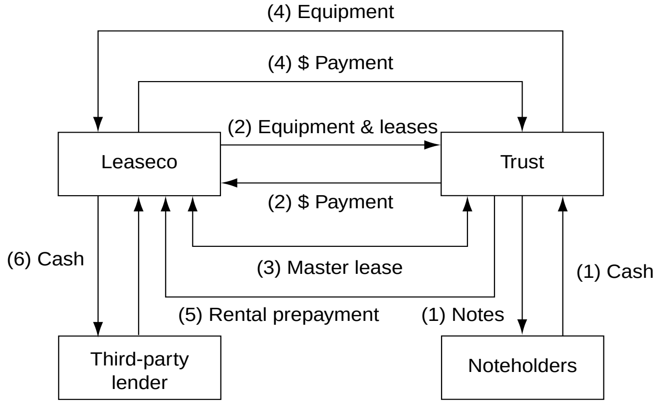
Prepaid Rent and Cap Tax

A final draft of *Interpretation Bulletin* IT-532, "The Tax on Large Corporations," was issued on June 30, 2000. The IT clarifies and documents Revenue's position on some of the more common issues that have arisen in the last 10 years or so since the large corporations tax (LCT) was introduced. Revenue reiterates its longstanding position that prepaid amounts, including rents, are included in the recipient's capital tax base as a loan or advance, mirroring Ontario's recent assessing practice. If Revenue's position is correct, then a lessor is at risk for capital tax if it has securitized to remove debt incurred to acquire leasing assets using a structure such as a sale-sale-leaseback or a concurrent lease—structures that rely on a prepaid rent feature.

It is no coincidence that the 1989 introduction of the LCT parallelled the increased popularity of securitization structures in Canada. Off-balance-sheet financing became critical to leasing companies to reduce LCT at 0.225 percent and provincial capital taxes, which range from 0.25 to 0.64 percent but are deductible for income tax purposes. If a lessor corporation financed its acquisition of leasing assets with debt that remained on the balance sheet, the annual related cost to the lessor might range between 37 and 60 basis points after tax. With the current razor-thin margins of lessors in Canada, such a cost would be fatal from a competitive standpoint. Capital taxes are levied on taxable capital, generally based on shareholders' equity, loans, advances, long-term debt, and other indebtedness, with a deduction for an investment allowance for certain investments, loans, and advances. For this purpose a lease is not considered a loan or advance, and a lessor cannot thereby offset balance-sheet debt incurred to finance the leasing assets' acquisition. This capital tax cost threatened lessors because the capital tax base of their financial institution competitors was calculated in a fundamentally different manner, and a leasing company could no longer elect financial institution treatment for capital tax purposes. Lessors became creative by necessity and sought innovative securitization structures to reduce their capital tax burden and place them on a level playing field with their competition.

The sale-sale-leaseback originally developed in 1990 was known as LEAF. The sale-sale-leaseback is still a common legal securitization structure in Canada for equipment assets. A trust was selected as the securitization vehicle because trusts are not subject to capital tax.

Assume that Leaseco incurs third-party debt to acquire equipment, which it then leases. In order to securitize, (1) Trust raises funds from investors and issues notes; (2) Trust purchases the equipment and related lease rights from Leaseco with the note proceeds; (3) a master lease is executed, with Leaseco as lessor and Trust as lessee; (4) Leaseco purchases the original equipment—but not any rights to the receipts under the related leases—for a purchase price equal to the original sale price and subject to the terms of the master leases; (5) Trust prepays a portion of the rental arising under the master lease; and (6) Leaseco



uses the prepayment proceeds to pay down debt that otherwise attracts capital tax.

The structure makes lower-cost funds available to Leaseco because of the trust conduit's bankruptcy-remote status: the rights and benefits transferred to Trust are enforceable against Leaseco, leaving Trust's cash flow insulated from operator risk associated with the originating lessor company. If Leaseco achieves the critical off-balance-sheet financing because Canadian GAAP for booking a sale is met, it reaps reductions in capital tax. (This article does not deal with the accounting rules or commodity tax issues.) However, Leaseco can also accelerate book income recognition in the period when assets are sold to the conduit for the future lease streams; simultaneously, by claiming a reasonable reserve, it can defer income tax on the book gain. There is no recapture or income inclusion to Leaseco by virtue of the securitization, absent tax class changes and certain previously filed tax elections. On the investor side, the senior notes that are issued by the trust provide an attractive money-market alternative because they are guaranteed by a bank. The senior notes are typically held by the more conservative investor, whereas the subordinate debt, mid-term notes, and junior debt tranches that also are often issued attract the more risk-oriented investor and broaden the source of funding to Leaseco in comparison with conventional financing.

Many tax practitioners are generally comfortable with Revenue's LCT position on prepaid rent not being sustained in a court of law if prepaid rent is not included in the lessor's balance sheet because of GAAP conformity and if the financial statement notes do not refer to the amount of the prepayment netted in the balance sheet. However, it is unfortunate that this structure is being challenged from a capital tax perspective, because many other parties are affected. Securitization provides a primary source of cost-effective funds for lessors that allows them to pass on benefits to lessees through lower lease rates. The lessors' competitors, financial institutions, do not suffer from the impediment of not receiving a capital tax deduction for financing extended to their customers. Furthermore, the bank-guaranteed notes issued by the conduit provide an attractive secured investment alternative for individuals.

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Cap Tax: Inventory Financing

A recent decision of the Ontario Superior Court in *QEW 427 Dodge Chrysler* has put an interesting twist on how one calculates paid-up capital for Ontario capital tax.

The taxpayer was a car dealership that financed its new vehicle purchases through a line of credit arranged with the manufacturer's credit subsidiary. The taxpayer entered into a conditional sales contract for each vehicle purchased from the manufacturer. The Ontario Corporations Tax Act had been amended in 1993, the last year in issue, to exclude current accounts payable from the calculation of paid-up capital. The taxpayer contended that the line-of-credit financing was classified as current accounts payable and the amounts were thus excluded from paid-up capital. After reviewing the legislative context—the inclusions and exclusions vis-à-vis current accounts payable—the court concluded that the term included amounts owing to a creditor (not just a supplier), including a financial institution, and that the accounts payable may be part of a line of credit, may be secured, and may bear interest. On the facts, the indebtedness created to finance each vehicle was repaid within a period of less than a year and hence was current as defined in the act. The court concluded that the terms "accounts payable" and "current accounts payable" encompassed the taxpayer's financing of new vehicle inventory, and its paid-up capital was reduced accordingly. (Similar amounts were included as loans or advances and secured indebtedness for the earlier years assessed.)

In contrast, the FCA in *Autobus Thomas* confirmed the TCC decision that bank debts incurred to finance purchases were included in capital for large corporations tax (LCT) purposes. The taxpayer ran a bus dealership: the bank paid the bus manufacturers directly for buses purchased and then charged the taxpayer's account. In the case of one of the two manufacturers involved, the manufacturer assigned to the bank its rights under conditional sales contracts between it and the taxpayer. The FCA found that the taxpayer's relationship with the bank was one of lender-borrower, not vendor-purchaser. All "loans and advances" to the taxpayer were included in its LCT base. The FCA said that the line of credit could only be construed as a loan commitment.

LCT does not specifically exclude current accounts payable from its base, as does Ontario capital tax. The *QEW 427* decision suggests that a loan and an account payable are not necessarily mutually exclusive terms, and thus loans that are also current accounts payable may be excluded from Ontario paid-up capital. Businesses should review their Ontario corporate returns to determine whether they may be able to reduce their paid-up capital by deducting inventory financing. Ontario Finance intends to appeal the Ontario case; the taxpayer in *Autobus Thomas* has also requested leave to appeal that LCT decision to the SCC.

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Mi'kmaq Treaties and GST

The TCC recently considered whether four individual Mi'kmaq Indians who carried on retail businesses on Nova Scotia reserves must collect and remit GST on sales to non-natives. *Pictou* looked at the effect of 18th-century treaties and the special tax status of Indians under the Indian Act in the context of otherwise taxable sales to non-native customers.

The facts were straightforward. The Indian retailers did not pay GST on goods purchased on-reserve by them (by virtue of section 87 of the Indian Act), nor did they collect GST from their Indian or non-Indian customers. Revenue assessed GST on the sales to non-Indians. The amount of tax

SHOE *by Jeff MacNelly*

assessed was not disputed, but the appellants argued that under the terms of 18th-century treaties between the Crown and the Mi'kmaq, they were not obliged to collect and remit GST. The appellants presented the treaty argument as if they were representative of the Mi'kmaq people as a whole, but the court saw its jurisdiction as being limited to the four specific assessments under appeal.

The treaty argument was premised on the right of the Indians to trade with non-Indians without collecting and remitting GST unless the Mi'kmaq nation consented to assume such an obligation. The court noted that there was no substantial difference among the appellants' two historian witnesses and Revenue's historian witness concerning the factual context of the treaties. A thorough review of that historical context and the wording of the treaties' trade provisions in particular, however, did not support the appellants' position: the treaties related solely to peace and trade, not taxation issues. Mi'kmaq trade in the products of traditional hunting and gathering activities was protected, but was not analogous to the appellants' substantial retail operations.

The argument that the collection of GST would increase the appellants' cost of goods and put them at a competitive disadvantage was quickly dispatched by noting that their competitors must collect GST. In fact, the appellants had a commercial advantage because their Indian status relieved them from paying GST on inventory and the consequent cash-flow disadvantage of recovering GST paid by claiming input tax credits. The court also rejected the suggestion that the treaties contemplated that the Crown must consult with the Mi'kmaq people on any new issues. The evidence established that under the treaties the Mi'kmaq acquired both the protection and the burdens of the British legal system. The appellants were thus not treaty-exempt from GST obligations of collection and remittance on taxable sales to non-Indians.

Alternatively, the appellants argued that the Indian Act protected them from being effectively taxed themselves as retail merchants by way of assessments for amounts equal to the taxes they had failed to collect on sales to non-Indians. Section 87 of the Indian Act exempts from taxation the interest of Indians and bands in reserve lands or surrendered lands and in personal property situated on a reserve. The TCC rejected this argument, referring to the SCC's *Reference re Goods and Services Tax*, which held that GST collection and remittance obligations did not result in any taking of property or a tax on the vendor. The court deflected the argument based on section 89 of the Indian Act, which protects the property of an Indian situated on a reserve from seizure, because collection action had not begun: only the assessments were in issue.

Pictou establishes that the Mi'kmaqs' business dealings with non-native customers are subject to the same GST obligations as any other business, although any particular treaty may need to be reviewed on the facts. The finding also echoes various SCC decisions that the Indian Act's tax provisions do not afford any special commercial or economic advantages to Indians beyond protecting interests in reserve lands and personal property situated on a reserve.

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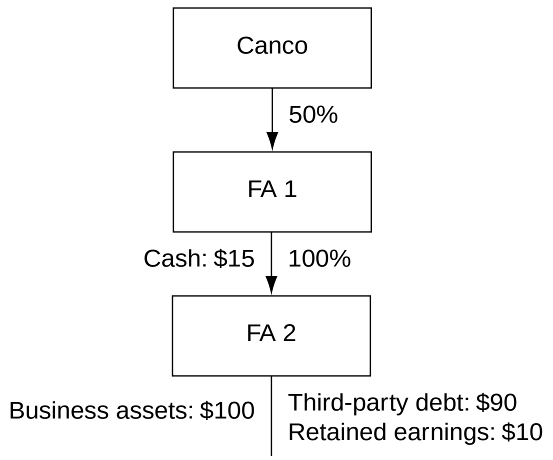
FIE's Significant Interest

The foreign investment entity (FIE) proposals released by Finance in June 2000 replace and expand existing rules that apply to offshore investment funds. (See "Foreign Investment Entities," *Canadian Tax Highlights*, July 25, 2000, at 49.)



A non-resident entity is an FIE if the carrying value of its investment property exceeds 50 percent of total assets. If the entity has a significant interest—generally, 25 percent or more of votes and value—in another foreign entity, the carrying value of the shares and debt of the other entity is deemed to be nil. Instead, the top foreign entity is deemed to own the underlying assets to the extent of its relative ownership interest. The underlying assets are then aggregated with the entity's own assets for measurement purposes. The results of this lookthrough rule can be very different from consolidation, because the deemed carrying value of the underlying assets is based on a formula that looks to the relative value of both shares and debt (including third-party debt) of the lower-tier entity.

Assume that Canco owns 50 percent of FA 1, a foreign affiliate holdco that has $15 of cash and 100 percent of FA 2's shares. FA 2 carries on an active business, and has business assets of $100 and third-party debt of $90. For the purposes of the 50 percent carrying value test, FA 2's assets are attributed to FA 1 based on the relative value of its ownership interest of both shares and debt of FA 2. Assuming that the shares of FA 2 have an FMV of $10 and that the total FMV of FA 2's debt and shares is $100, FA 1 is deemed to own business assets of only $10 in addition to its actual ownership of $15 cash. FA 1 is therefore an FIE and Canco is taxed, using the accrual or mark-to-market method, with respect to its direct and indirect ownership interests in both FA 1 and FA 2. A liquidation of FA 2, or a merger of FA 1 and FA 2, eliminates the FIE taint because the carrying value of the single foreign entity's investment property ($15) is not more than 50 percent of total assets ($115).

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Offshore Estate Freezes

Assume that a non-resident trust (NRT) with Canadian-resident beneficiaries was settled by a non-resident, and that before June 23, 2000 the NRT acquired 100 percent of the common shares in a Canadian holdco newly incorporated by it. A Canadian resident then rolled shares of a Canadian opco to the holdco in exchange for redeemable preference (freeze) shares. The existing section 94 clearly excepts such a structure, because no property was acquired by the NRT or a non-Canadian corporation controlled by it. (The property was acquired by a Canadian-resident corporation controlled by the NRT.) What is not clear is how the proposed NRT rules in section 94 apply to such a fact pattern, and in particular whether then existing international estate freezes are grandfathered.

Under draft revisions to section 94, any property transferred by a Canadian resident to an NRT may result in the trust's becoming a resident of Canada. Clearly, under paragraph 94(2)(g), offshore estate freezes involving trusts cause the NRT to be a Canadian resident. That rule deems the issue of the Canadian holdco shares to the NRT to be a transfer of property and hence a contribution. An arm's-length transfer exception is unlikely to apply in most estate freezes, and thus the proposal deems the NRT to be a Canadian resident. But the proposal applies to shares issued after June 22, 2000, implicitly validating the offshore estate freeze and grandfathering then existing structures. However, a presumed grandfathering appears undermined by the possible application of draft paragraph 94(2)(b). Although the explanatory notes describe this rule's application only generally, it may apply to an offshore estate freeze implemented in the manner described above, rendering the NRT a resident of Canada beginning after 2000 notwithstanding the grandfathering in draft paragraph 94(2)(g).

On its face, draft paragraph 94(2)(b) appears intended to deal with derivatives—that is, the NRT owns property that derives its value from another person's (the recipient's) property. A Canadian resident transfers property to the recipient, a transaction designed presumably to enhance the recipient's value and thus increase the value of the derivative product held by the NRT. This indirect transfer is caught under paragraph 94(2)(b), but its scope may be broader. For example, the provision may be read to include shares of a corporation owned by the NRT (the Canadian holdco in the example) that derive their value in part from assets held by the corporation (the shares in Opco rolled by the Canadian resident in the example). Unless it can be shown that the reason for the transfer by the Canadian resident to Holdco was not due to any relationship between the Canadian-resident transferor and the trust, its beneficiaries, trustees, protectors, etc., the transfer is deemed to be a transfer to the NRT. Thus the NRT is deemed to be resident in Canada notwithstanding that the structure was implemented before June 23, 2000 and is otherwise grandfathered under draft paragraph 94(2)(g). The result seems anomalous, and it is hoped that the scope of draft paragraph 94(2)(b) will be narrowed to more closely align with its apparently intended target of derivatives. The rule as drafted also seems to render paragraph 94(2)(a) redundant. It is difficult to imagine a situation in which that rule applies and paragraph 94(2)(b) does not.

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Employee or Not?

It is increasingly common for individuals to work "on contract" or as consultants rather than as employees. These self-employed people generally have wider scope for deducting expenses and tax planning than employees. They do not pay EI premiums, but if their contract terminates and they are left without work, they cannot claim benefits from EI. Businesses can also benefit from "contracting" by saving the cost of payroll taxes and employee benefits, but they risk penalties for failure to make source deductions if it turns out that the relationship is actually one of employer and employee. Ontario Finance recently issued employer health tax (EHT) bulletins setting out factors to consider in determining whether an employer-employee relationship exists. These bulletins may also be helpful in making the determination for income tax, CPP, and EI purposes.

EHT *Bulletin* 1-96 (revised)—"How To Identify an 'Employer-Employee Relationship' "—discusses the four tests established by common law: control, ownership of tools, chance of profit or risk of loss, and integration. Along with the terms and conditions of the worker's "employment," Ontario Finance will consider Revenue rulings regarding CPP and EI and has considered Revenue's guidelines for certain industries in developing its own information bulletins.

New EHT *Bulletin* 2-00—"Commissioned Real Estate Salespersons: How To Identify an 'Employer-Employee Relationship' "—provides more specific comments regarding whether an employer-employee relationship exists between com-

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missioned real estate salespersons and real estate brokers. According to criteria developed by Revenue, a real estate salesperson is considered self-employed for EHT purposes if the salesperson is legally entitled to the full amount of the gross sales commissions and must pay to a broker, for administrative and operating costs, an amount that is either a fixed amount or, if the salesperson sets his or her own commission rate for listings, a fixed percentage of gross commissions. If these criteria are not met, Ontario Finance will investigate further to determine the substance of the relationship. The bulletin sets out a series of questions that may be asked in order to apply the common law tests.

EHT *Bulletin* 3-00—"Placement Agencies and Their Workers: How To Identify an 'Employer-Employee Relationship' "—discusses relationships between placement agencies and their workers, and generally concludes that an employer-employee relationship exists if a worker is hired by an agency and placed on assignment with a client. However, a professional specialist, such as an engineer, draftsman, surveyor, doctor, technician, computer consultant, or other individual who does not require strict instruction from the agency or the contracting client as to how to perform the task assigned, may be in a different position: such an individual is not considered a placement agency's employee if he or she is engaged by the agency for the sole purpose of performing services for the agency's client. The bulletin sets out a series of questions that Ontario Finance may ask to apply the common law tests in placement agency situations.

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Foreign Tax News

Isle of Man

Proposed tax reforms, said to meet OECD criteria, include removing the ring-fence around exempt insurance and shipping companies to apply the domestic tax system at a zero tax rate; reducing the corporate tax rate from 20 to 10 percent for trading companies; simplifying capital allowances; assessing personal income on a current-year basis; and reducing the top rate of income tax to 15 percent and the standard rate to 10 percent. The OECD is optimistic that the Isle of Man and the Channel Islands will amend their tax regimes and avoid OECD sanctions threatened against harmful tax jurisdictions.

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Czechoslovakia[2]
Denmark
Dominican Rep.
Egypt
Estonia
Finland
France
Germany
Guyana
Hungary
Iceland
India
Indonesia
Ireland
Israel
Italy
Ivory Coast
Jamaica
Japan
Kazakhstan
Kenya
Korea (Rep.)
Latvia
Lithuania
Luxembourg
Malaysia
Malta
Mexico[3]
Morocco
Netherlands
New Zealand
Nigeria
Norway
Pakistan
Papua New Guinea
Philippines
Poland
Romania
Russia
Singapore
South Africa
Spain
Sri Lanka
Sweden
Switzerland
Tanzania
Thailand
Trinidad & Tobago
Tunisia
Ukraine
United Kingdom
United States
USSR[4]
Vietnam
Zambia
Zimbabwe

Signed but not yet in force (10)
Algeria[5]
Austria[6, 7]
Bulgaria[5]
Japan[5, 6]
Jordan[5]
Kyrgyzstan[5]
Lebanon[5]
Luxembourg[5, 8]
Portugal[5]
Uzbekistan[5]

Under negotiation (renegotiation) (30)
Armenia
Australia[6]
Barbados[6]
Belgium[8]
Colombia
Czech Rep.
Ecuador
Egypt[8]
Gabon
Germany[8]
Greece
Ireland[8]
Italy[8]
Kuwait
Mauritius
Mexico[8]
Moldova
Mongolia
Norway[8]
Romania[8]
Saint Lucia
Senegal
Singapore[8]
Slovak Republic
Slovenia
Turkey
United Arab Em.
United Kingdom[6]
United States[6]
Venezuela

[1] This convention does not apply to Hong Kong. [2] Continues to apply to both the Czech and Slovak republics. [3] A convention for the exchange of information is also in force. [4] No longer applies to any former republic of the USSR. [5] Part of Bill S-3, approved by the Senate on December 16, 1999. First reading in the House of Commons was on February 16, 2000. [6] Protocol. [7] In Canada, the enabling legislation for the existing treaty with Austria provides that the treaty can be amended by order in council: see Order in Council PC 1999-1778, approving the current protocol. Approval of the protocol by Austria is still pending. [8] Will eventually replace the existing treaty.

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