"Black is the new grey" - Treaty interpretation in the Conrad Black appeal

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Winston Churchill said there is “no such thing as a good tax” and thus it surely follows that no good can come from double taxation. While it’s difficult to feel sympathy for Lord Black who earned approximately $3.39 million with another $1.7 million of taxable benefits in 2002, the underlying principles are important to all who rely on the relief provided in tax treaties to avoid double taxation. Many Canadians are subject to double taxation, for instance if you work in another country or simply earn money from another country (i.e. dividends on US stocks). Generally speaking, the country where you earn the income (let’s assume it is the US) has the right to tax this income as it is derived from that country. However, Canada may also have a right to tax the income since Canadian residents are taxed on their worldwide income regardless of where they earn the income. Therefore an individual may be taxed twice on the same income –double taxation! Now what happens if both the US and Canada assert a right to tax your income? The Canada-US tax treaty would allocate taxing authority to either Canada or the US, but not both, as one of the primary functions of a bi-lateral tax treaty is to relieve persons from double taxation.

Unfortunately, Black was not able to avail himself to the benefits of Canada’s tax treaty with the United Kingdom (the “Treaty”) as the Tax Court of Canada recently ruled that the Treaty did not apply to his situation. Black was factually resident in both Canada and the UK during 2002 and as such potentially subject to tax by both countries. By virtue of Article 4(2)(a) of the Treaty, commonly referred to as the tie-breaker rules, Black was deemed to be a resident of the UK and was liable to taxation therein. The Court stated that the Treaty gives preference or priority for taxation, but is not an override of Canadian domestic law.

At a basic level, treaties are agreements between countries where one country contracts out of the right to tax in certain pre-determined situations. Ordinarily the Treaty would prevail over the *Income Tax Act* (the “Act”) because of the legislation that implements the Treaty into Canadian law, the *Canada-U.K. Income Tax Convention Act 1980,* states that this is the case to the extent of any inconsistency between the Act and the Treaty. However, the Minister of National Revenue (the “Minister”) asserted that the Treaty did not prevail over the Act in this particular situation since the Treaty only prevails when there is conflict or contradictions between the Act and the Treaty. This unusual result stems from the fact that certain residents of the UK are only subject to taxation when they remit or receive the income in the UK.

In brief, the Court agreed with the Minister and essentially adopted a results-based approach, holding that since Black was not subject to a comprehensive tax system, as his income was not remitted to or received in the UK, he should not be able to benefit from the Treaty. Accordingly, the majority of his income (interestingly determined on an item-by-item basis) was subject to tax in Canada. In other words, the Treaty was interpreted to apply to “income [that] is subject to tax in the UK by reference to the amount that is remitted or received in the UK, [thus] Canada may tax the amount of income that has not been remitted to, or received in, the UK”.

From ten thousand feet, the approach of the Court appears to be questionable as they looked at each type of income separately to determine who had taxing authority. While the Court did consider the

residency tie-breaker provisions in Article 4 of the Treaty, the Court spoke to income on an item-by-item basis and looked to the specific Treaty provisions dealing with each respective type of income to determine how such income should be taxed. This approach appears to bring into question how one should interpret a treaty, as one may have thought that the tie-breaker provisions in the Treaty, which determined Black to be resident of the UK, would have been determinative of his taxing position, thus giving the UK (and not Canada) the right to tax all income. It should be noted that the Article 4 residency provisions precede those provisions in the Treaty which speak to specific types of income.

Although not enacted in 2002, Article 20A(1) deals with other income stating that such income beneficially owned by a resident not specifically dealt with elsewhere in the Treaty will be taxable only in the place where the person is resident. If this Article had been in effect for the tax year in question, it appears some of Lord Black's income would have been liable to tax in the UK regardless of whether it was remitted to or received in the UK. However, Article 20A(3), also not enacted in 2002, of the Treaty allocates taxing authority to the jurisdiction from which specific income arises. Therefore, some of Lord Black's income may have not been caught by Article 20A, if it was enacted, due to the more specific provision of Article 20A(3). Subsection 250(5) of the Act, which deems an individual not to be resident in Canada if that person is resident elsewhere as determined by a Treaty, is another provision that would have to be considered should the Court hear a case on this issue for a more current taxation year. In other words, it is questionable how much precedent this case has given that if Lord Black's facts arose today the Court would have to take into consideration subsection 250(5) of the Act and Article 20A of the Treaty.

One cited purpose of tax treaties is to prevent fiscal evasion – it is interesting to consider how this purpose may have affected the Court's decision. One also has to consider whether income that is not taxed by a treaty partner due to their own domestic laws simply becomes available for tax by the Canada. If the decision is correct, we feel this case may have broad implications, specifically for Canadian residents who earn income in countries without a tax treaty with Canada or where the income earned is not specifically addressed by a treaty as the Canada may consider such income to be subject to tax in Canada.

As expected, Black has already filed an appeal of this decision to the Federal Court of Appeal, so stay tuned for further commentary on this matter.