

“CAN’T BE NAILED TWICE”:
AVOIDING DOUBLE TAXATION BY CANADA AND TAIWAN

by

EMILY HSIANG-HUI LEE

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Department of Faculty of Law
The University of British Columbia
Vancouver, Canada

Date Dec. 17, 1998

ABSTRACT

Canada and Taiwan have not entered into a tax treaty. Consequently, because each jurisdiction uses different connecting factors, that is 'residence' in Canada and 'income source' in Taiwan, double taxation may occur for individuals subject to tax in both jurisdictions. With the increasing number of Taiwanese immigrants to and investors in Canada, double taxation is becoming a significant problem. A treaty is probably the most efficient mechanism to resolve the double taxation problem. However, the political issue is how can a nation (Canada) enter into a treaty with a jurisdiction (Taiwan) that it does not recognize as a nation state? Despite facing the same problem, on May 29, 1996 Australia signed a tax agreement with Taiwan concerning the avoidance of double taxation and the prevention of tax evasion. The Australia-Taiwan Tax Agreement is unique because it was signed by two private sector organizations rather than by the respective governments. Using the same mechanism, New Zealand and Vietnam have signed tax agreements with Taiwan as well. This thesis analyses the likelihood of Canada entering into a tax treaty with Taiwan. In so doing, it considers how double taxation arises, reviews the foreign reporting rules and argues that a tax treaty between Canada and Taiwan is desirable.

The conclusion is that, theoretically and pragmatically, a tax treaty (or agreement) between Canada and Taiwan is possible and needed in order to relieve punitive double

taxation and to facilitate bilateral economic and trading relations between the two jurisdictions.

TABLE OF CONTENTS

ABSTRACT	ii
TABLE OF CONTENTS	iv
ACKNOWLEDGMENT	vii
Chapter I -- INTRODUCTION	1
Chapter II -- HOW DOES DOUBLE TAXATION COME ABOUT ?	6
1. Introduction	6
2. How Does Double Taxation of Individual Income Come About?	6
<i>2.1 Domestic Source Income -- Connecting Factor in Taiwan</i>	<i>7</i>
2.1.1 Concept of Domestic Source Income in Taiwan	7
2.1.2 Three Personal Income Tax Systems	11
2.1.3 The Personal Income Tax System Used in Taiwan	17
<i>2.2 Residence -- Principal Connecting Factor in Canada</i>	<i>17</i>
2.2.1 Concept of Residence	17
2.2.2 Definition of Residence -- The Case Law	20
(1) Residence	20
(1.1) Deemed Resident	25
(1.2) Ordinarily Resident	34
(2) Part-time Residence	37
(3) Non-resident	40
<i>2.3 Personal Link System and Territorial System</i>	<i>48</i>
2.3.1 Comparison of Personal Link System and Territorial System	49
2.3.2 A Blend of Personal Link System and Territorial System	50
2.3.3 Personal Link System in Canada	52
2.3.4 Territorial System in Taiwan	55
3. Conclusion	58
Chapter III -- TO GO OR NOT TO GO, THAT'S THE QUESTION!!	59
1. Introduction	59
2. Impact of the Foreign Reporting Rules	60
<i>2.1 Comments on Foreign Reporting Rules</i>	<i>64</i>
2.1.1 The foreign reporting rules are a violation of privacy	64
2.1.2 They are a forerunner of a wealth tax	67
2.1.3 They unfairly target wealthy new Canadians and drive wealthy immigrants out of Canada	69
2.1.4 The \$100,000 limit is too low; it discourages foreign investors	71

2.1.5 An alternative to improve compliance and increase revenue	73
2.2 <i>My Perspective</i>	76
2.2.1 The tax burden is brought into sharp relief by the Foreign Reporting Rules	76
2.2.2 The <i>Rules</i> are not a cure all for tax evasion	78
2.2.3 Some changes to the <i>Rules</i> are needed	80
2.2.4 The full enforcement of the <i>Rules</i> is very difficult	82
2.2.5 Simplicity is one of the goals to achieve in a good tax system	83
3. Tax Residence vs. Permanent Residence	84
3.1 <i>Losing Permanent Resident Status Also Means Losing Canadian Citizenship?</i>	88
3.2 <i>Losing Permanent Resident Status, But Still Having To Pay Tax?</i>	96
4. Conclusion	99

Chapter IV -- A TREATY BETWEEN CANADA AND TAIWAN IS NEEDED

A PRECEDENT: AUSTRALIA-TAIWAN TREATY	102
1. Introduction	102
2. Treaty	103
2.1 <i>General Discussion of Treaties</i>	103
2.2 <i>Benefits of Tax Treaties</i>	105
2.3 <i>Tie-breaker Rules to Determine Residency</i>	105
2.3.1 The function and purpose of the tie-breaker rules	107
2.3.2 What are the 'Tie-breaker Rules'?	109
(1) Permanent home	109
(2) The closest personal and economic relations	110
(3) Habitual abode	111
(4) Citizenship or nationality	112
(5) The competent authorities	112
2.3.3 Use of the tie-breaker rules	112
3. Political Dilemma	113
3.1 <i>Problem of Taiwan</i>	113
3.2 <i>Non-recognition</i>	114
3.3 <i>Alternatives</i>	117
3.4 <i>Canada and Taiwan Should Have a Treaty/ an Agreement</i>	125
4. A Precedent -- the Australia-Taiwan Tax Agreement	132
5. Bringing a Tax Agreement into Effect	133
5.1 <i>The Australian Practice</i>	134
5.2 <i>The Canadian Practice</i>	137
5.2.1 The treaty-making power in Canada	137
5.2.2 The implementing of a treaty in Canada	141
5.3 <i>Sub-conclusion</i>	146
6. A Hypothetical Treaty Between Canada and Taiwan	147
6.1 <i>The Three Model Treaties</i>	148
6.2 <i>Comparison of the Three Model Treaties with Respect to 'Residence'</i>	149
6.2.1 Comparison of the OECD Model and the U.S. Model	149

6.2.2 Comparison of the OECD Model and the U.N. Model	151
6.2.3 Comparison of the U.S. Model and the U.N. Model	153
6.3 <i>Comparison of Treatment of Capital in the Three Model Treaties</i>	155
6.3.1 OECD Model : favours the capital exporting nations	155
6.3.2 U.S. Model : favours the capital exporting nations	155
6.3.3 U.N. Model : favours the capital importing nations	156
6.4. <i>Hypothetical Canada-Taiwan Tax Treaty (Agreement) -- What Model to follow?</i>	
6.4.1 Canada is one of the OECD member countries	159
6.4.2 OECD Model is the most widely-used model treaty	160
6.4.3 Taiwan would prefer to have the treaty follow the OECD Model	162
7. Negotiation	165
8. Relative Strength of Canadian and Taiwanese Negotiation Positions	169
9. Conclusion	170
 Chapter V -- CONCLUSION	 172
 BIBLIOGRAPHY	 187
 Appendix I: Definitions of the term "resident" in the three model treaties	 195
Appendix II: Immigrants to Canada by Class, 1986-93	198
Appendix III: Immigration by Class, 1994-96	199
Appendix IV: Business Immigration - Top Ten Source Countries	200
Appendix V: Five Key Issues compared in the treaties of the U.N. Model, the OECD Model, and the Australian treaties with U.S., P.R.C., and Taiwan	201

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Chapter I

INTRODUCTION

There are economic, administrative, social and political ramifications involved in deciding who should be subject to the income tax of a particular nation when a taxpayer is potentially subject to tax in more than one jurisdiction. Treaties are probably the most efficient mechanism to provide the answer. However, the interpretation of treaties hinges on the contracting states' local laws. As a result, in a bilateral treaty, both contracting states may have the authority to tax the same individual on the same income, in accordance with their respective taxation laws, and thus double taxation occurs. Countries negotiate bilateral income tax treaties to prevent double taxation and to allocate taxing jurisdiction in a way that will encourage trade and investment. 'The principal function of income tax treaties is to facilitate international trade and investment by removing - or preventing the erection of - tax barriers to the free international exchange of goods and services and the international movement of capital and persons'.¹ To this end, it makes a lot of sense that most of the provisions of a tax treaty apply to the corporate tax context.

Most treaty provisions focus on the taxation of corporate income and tend not to deal with individual issues. This thesis, however, will focus on issues that apply to individuals.

¹ Federal Income Tax project, International Aspects of United Income Taxation II, Proposals on United States Income Tax Treaties, American Law Institute I (1992).

The reason is that individual income tax is more important than it appears to be in tax treaties. In most countries the tax system relies heavily on individual income tax for revenues rather than corporate tax.² Moreover, double taxation often occurs in individual income tax when two states are without a tax treaty and use different connecting factors (for example: residence, citizenship or domestic source income) to subject individuals to income tax. Since an individual with the same income should bear the equivalent share of sacrifice, double taxation nails the same individual twice, which is against the ability to pay principle³ in a fair tax system.

With the increasing number of Taiwanese immigrants to and investors in Canada, double taxation is a problem for an increasing number of individuals. Thus, in chapter two, I shall seek to find the root of the problem of double taxation by Canada and Taiwan. In Canada, an individual is subject to tax on his/her worldwide income as long as he/she is regarded as

² According to the Commons Debates in the House of Commons of Canada, '[the figures from the OECD indicate that] in the United States, for the year 1965, 6.48 per cent of tax revenues came from corporations, compared to 4.7 per cent for Canada, 12 per cent for France, 7.23 per cent for Germany, and 5.81 per cent for Japan. In 1965, Canada, along with Spain and the United Kingdom, was the country with the smallest proportion of tax revenues being paid by corporations. In 1975, ... the percentage for Canada was 6.38, and for the United States, 7.16. ... In 1993, Canada looked to corporations for less than 6 per cent of its revenue, the United States, 7.25 per cent, and Japan, almost 10 per cent'. See: *House of Commons Debates* (18 April 1997) at 9926.

³ The ability to pay principle requires equal taxation of people with equal ability to pay and unequal taxation of people with unequal ability to pay. The ability to pay principle considers tax fairness in relation to the capacity of the individuals to pay taxes. Its basic premise is that the economic circumstances of taxpayers differ, and that these differences should be the basis of allocating the shared responsibility with respect to the costs of government-provided goods and services. Theoretically, by defining the tax-paying unit and the measure of tax-paying capacity, the ideal of 'horizontal equity' - that 'similar' taxpayers should be treated in a 'similar' fashion - could be satisfied. One criterion for 'horizontal equity' is that those with an equal ability to pay should pay a similar amount. See: Fair Tax Commission, *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission* (Toronto: University of Toronto Press, 1993) at 1090.

resident in Canada, while in Taiwan, individual income tax is imposed on the individual's income earned or gained in Taiwan. For example, due to the lack of a treaty between Canada and Taiwan, if a Taiwanese individual who immigrates to or does business in Canada and is regarded as resident in Canada has Taiwan-source income and has already paid tax on it in Taiwan, that individual is not exempted from Canadian income tax by a tax credit granted in the state of residence, Canada. The taxpayer thus has to pay tax again in Canada, and double taxation occurs.

After the Foreign Reporting Rules (hereinafter referred to as 'the *Rules*') were incorporated into the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c.1. (hereinafter referred to as 'the *Act*') in 1997, as the *Income Tax Budget Amendments Act, 1996*, S.C. 1997, c.25., commentators have speculated that the *Rules* have affected many immigrants' decision whether to go or not to go to Canada, and for those immigrants already landed in Canada, whether to leave or to continue to stay. These issues will be covered and discussed in chapter three which will demonstrate that the implications of the respective residence concepts, 'tax residence' in the *Act* and 'permanent residence' in the *Immigration Act*, R.S.C. 1985, c. I-2 (hereinafter referred to as 'the *Immigration Act*'), are different, even though they interact with each other.

A treaty is probably the most efficient mechanism to solve the double taxation problem. However, the political dilemma is how can a country enter into a treaty with a jurisdiction that it does not recognize as a nation state. Despite this political dilemma, Australia, on

May 29, 1996, signed a unique tax agreement with Taiwan concerning avoidance of double taxation and prevention of tax evasion. The Australia-Taiwan Tax Agreement is unique because it was signed by two private⁴ sector organizations, namely, 'The Taipei Economic and Cultural Office' and 'The Australian Commerce And Industry Office', rather than governments. In the same way, New Zealand and Vietnam have signed tax agreements with Taiwan as well, after the signing of the Australia-Taiwan Tax Agreement. Australia and Canada are very similar in that politically they do not recognize Taiwan as a state, but economically, Canada, like Australia, has strong and continuing economic relationship with Taiwan. In addition, Canada and Australia are two of the favoured countries that the Taiwanese choose to immigrate to. Moreover, Canada and Australia are both countries importing capital from Taiwan. Thus, chapter four will address the potential of having a treaty (or agreement) between Canada and Taiwan to avoid double taxation by using the Australia-Taiwan Tax Agreement as a precedent.

In the hope of resolving the double taxation issues with the generally accepted rationales which underlie model treaties, namely, (i) the Organization for Economic Co-operation and Development Model Convention (OECD Model), (ii) the United Nations Model Double Taxation Convention Between Developed and Developing Countries (U.N. Model), and (iii) the United States Model Tax Convention (U.S. Model), it is worthwhile analyzing the similarities and differences of these model treaties. The OECD and the U.N. Models are the most important and accepted models used for international double tax

⁴ See: footnote 50 in chapter 4.

treaties. 'Developing countries have not found that the OECD Model[s] are suitable to their tax policies, as, from their perspective, the OECD overemphasizes the right to tax in the state of residence and does not give enough room to the state of source to impose taxation. This led to the publication by the United Nations of its model treaty in 1984'.⁵ The OECD Model favours capital exporting countries, while on the contrary, the U.N. Model is biased more to the benefit of capital importing countries. In light of the fact that Australia and Canada are both capital importing countries relative to Taiwan, in chapter four I shall expand the discussion to include an analysis of which model treaty the potential Canada-Taiwan Tax Agreement could follow. Following the precedent of the Australia-Taiwan Tax Agreement, it is predicted that the tax treaty (or agreement) between Canada and Taiwan would be based on the OECD Model, but would be negotiated and adjusted toward the U.N. Model to be more beneficial to Canada, even though Canada is one of the OECD members and most Canadian treaties follow the OECD Model.

In conclusion, it is suggested that, theoretically and pragmatically, a tax treaty (or agreement) between Canada and Taiwan is needed to relieve punitive double taxation. This thesis is intended to provoke discussions of the best way of resolving the problem of double taxation by Canada and Taiwan for Taiwanese immigrants to and investors in Canada or Canadians with Taiwan source income.

⁵ Ward, D.A., "Canada's Tax Treaties" (1995) 43 Canadian Tax Journal at 1720.

Chapter II

HOW DOES DOUBLE TAXATION COME ABOUT ?

1. Introduction

This chapter starts with a discussion of how double taxation of individual income by Canada and Taiwan comes about. Then the implications of the respective connecting factors, that is 'residence' in Canada and 'income source' in Taiwan, will be illustrated from the statutory law and/or case law perspectives. Lastly, the two different tax systems, namely, the Personal Link System in Canada and the Territorial System in Taiwan, will be compared to enhance understanding of the double taxation problem between the two jurisdictions.

2. How Does Double Taxation of Individual Income Come About?

In Taiwan, individual income tax is imposed on the individual's income earned or gained in Taiwan (domestic source of income). In Canada, the individual is subject to tax on his/her worldwide income as long as he/she is regarded as resident in Canada. For example, due to the lack of a treaty between Canada and Taiwan, if a Taiwanese who immigrates to or does business in Canada and is regarded as resident in Canada has Taiwan-source income and has already paid tax on it in Taiwan, that individual is not

exempted from Canadian income tax by a tax credit granted in the state of residence, Canada. The taxpayer thus has to pay tax again in Canada, in accordance with the *Act*, and double taxation occurs.

In other words, double taxation between Canada and Taiwan comes from the different connecting factors utilized by the two jurisdictions, that is Canada imposes tax on an individual who is regarded as resident in Canada, while Taiwan taxes an individual who earned or gained income in Taiwan. The lack of a treaty between them results in both jurisdictions having the authority to tax the same income.

2.1 Domestic Source Income -- Connecting Factor in Taiwan

2.1.1 Concept of Domestic Source Income in Taiwan

The connecting factor used in Taiwan for income tax purpose is domestic source income, which means any income that is earned or gained by individuals in Taiwan is subject to Taiwan's income tax. Article 2 of the income tax law of Taiwan says:

For any individual having income from sources in the Republic of China (Taiwan), consolidated income tax shall be levied in accordance with this law on his/her income derived from sources in the Republic of China¹

Therefore, 'Consolidated Income Tax' will be imposed on an individual, whose income is earned or gained in Taiwan, the income source country.

¹ Article 2 of the income tax law of the Republic of China (Taiwan). See: Industrial Development and Investment Center, *Income Tax Law (in Taiwan)*, trans. Lee & Li Attorneys-at-law, (Taipei: Industrial Development and Investment Center, MOEA, 1995) at 1.

However, the definition of domestic source income can be ambiguous and must be refined. For example, in determining whether the salary income is Taiwan-source, different criteria can be used: (1) the place where the service is provided (2) the place where the employment contract is made (3) the place of salary payment (4) the residence of the employer.² Different conclusions can be reached when the different criteria are utilized.

The criteria in determining domestic source income from Taiwan are listed in article 8 of the income tax law of Taiwan. Thus, the term 'income from sources in the Republic of China' includes the following:³

(1) Dividend Income: dividends distributed by companies incorporated and registered in accordance with the Company Law of the Republic of China and by foreign companies authorized by the government of the Republic of China to operate within the territory of the Republic of China are subject to Taiwan tax;

(2) Profit Income: profits distributed by profit-seeking enterprises organized in the form of a cooperative or a partnership within the territory of the Republic of China are subject to Taiwan tax;

(3) Remuneration for services: remuneration for services rendered within the territory of the Republic of China are subject to Taiwan tax. There are three exceptions to this.

² Wang, J.S., *Taxation Law (in Taiwan)* (Taipei: Wen-sheng Publishing Company, 1996) at 69. (In Chinese).

³ *Ibid.* at 70 - 71.

First, tax shall not be applied to remuneration obtained from an employer based outside the territory of the Republic of China by an individual not residing in the Republic of China but staying in the Republic of China for a period of not more than ninety days during a taxable year. Secondly, remuneration for services performed by personnel sent abroad by the government of the Republic of China on overseas missions and for services rendered abroad by employees in general is taxed. This source of income is still regarded as domestic source income from Taiwan regardless of whether the service is rendered within the territory of the Republic of China or not. Thirdly, where a foreign profit-seeking enterprise, having been approved to make investment in the Republic of China under the Statute for Investment by Overseas Chinese or the Statute for Investment by Foreign Nationals, has dispatched its directors, managerial officers or technical personnel to the Republic of China to perform temporary work such as making investments, plant construction or market surveys, and has had them reside in the Republic of China for a period of less than 183 days in aggregate in a taxable year, their salaries paid outside the Republic of China by the foreign profit-seeking enterprise shall not be considered income earned in the Republic of China.⁴

(4) Interest Income: interest obtained from governments of various levels of the Republic of China, from juristic persons within the territory of the Republic of China and from individuals residing in the Republic of China is subject to Taiwan tax;

(5) Rental Income: rental income obtained from the lease of property situated within the territory of the Republic of China is subject to Taiwan tax;

⁴ See: article 12 of the Statute for Upgrading Industries, MOEA (1995) at 12.

(6) Royalty Income: royalties obtained from patents, trademarks, copyrights, secret formulas and franchises by virtue of their being made available for use by other persons within the territory of the Republic of China are subject to Taiwan tax. Therefore, as long as the rights to the intellectual property are utilized by other persons within the territory of the Republic of China, the income will be regarded as income from the Republic of China regardless of whom the right belongs to.

(7) Property Income: profits⁵ from the property transactions within the territory of the Republic of China are subject to Taiwan tax;

(8) Profit Income: profits from the operation of industry, commerce, agriculture, forestry, fishery, animal husbandry, mining, and metallurgy enterprises within the territory of the Republic of China are subject to Taiwan tax;

(9) Income from Awards or Grants: awards or grants obtained from participating in various skill contests, games or lotteries, etc. within the territory of the Republic of China are subject to Taiwan tax;

(10) Other Income: any other income, for example: income from the operation of a child care center, kindergarten, or alimony received due to divorce court judgment,⁶ obtained within the territory of the Republic of China is subject to Taiwan tax.

⁵ The term 'income from the transaction of property', as used in the Income Tax Law of Taiwan, refers to profits resulting from sale, purchase, or exchange of property by a taxpayer, who comes to possess the property other than engaging in regular sales and purchases of such properties for profit-seeking purposes. See: article 9 of the Income Tax Law of Taiwan. See also: Industrial Development and Investment Center, *Income Tax Law (in Taiwan)*, trans. Lee & Li Attorneys-at-law, (Taipei: Industrial Development and Investment Center, MOEA, 1995) at 16 - 17.

⁶ See *supra* note 2 at 74.

Analysis of the article 8 of the income tax law of Taiwan demonstrates that various criteria are used to determine different income sources in Taiwan.

2.1.2 Three Personal Income Tax Systems

‘Consolidated Income Tax’, which is used in Taiwan, is one category of personal income tax. Tax systems vary from country to country and the concept of tax on personal income varies in different tax systems, namely, (1) Classified Income Tax, (2) Consolidated Income Tax, and (3) Classified and Consolidated Income Tax.⁷

First, Classified Income Tax categorizes different sources of income⁸ that are subject to income tax, in accordance with the income tax law, and then applies differential tax rates on different categories of income. For income earned via labour, for example, salaries and wages, lower tax rates are applicable, while income gained due to non-labour activities, for example, rent and interest, are taxed at higher tax rates. The Classified Income Tax can be used as a vehicle to stimulate the individual’s willingness to labour, due to lower tax rates applicable on this income. Since income from different sources is taxed upon

⁷ Chang J.D., *Income Tax Law (in Taiwan)* (Taipei: Wu-nan Publishing Company, 1996) at 17 - 19. (In Chinese).

⁸ The Classified Income Tax categorizes different sources of income which include: (1) income from salaries and wages (2) income from interest (3) dividend income (4) income from profit-seeking (5) income from royalties (6) income from lease (rental) (7) profits from the property transactions (8) income from professional practice (9) income from games, lotteries and from prizes and awards won by chance (10) income from self-employment in farming, fishing, animal husbandry, forestry and mining. See: Chen J.M., *Income Tax (in Taiwan)* (Taipei: Business Journal Publishing Company -- Shang-yhei Zhou Kan in Chinese, 1998) at 6. (In Chinese).

receipt, there is no need for individuals to file separate tax returns. This is advantageous to the tax authority because that tax collection burden can thus be alleviated. However, the Classified Income Tax does not account for an individual's income *in toto* and then subject it to tax by progressive tax rates⁹. This is its weakness as it does not satisfy the principle of ability to pay¹⁰ and the goal of income redistribution. Therefore, Classified Income Tax can only be appropriate in less developed countries. In these countries, where the average income is lower, the tax base¹¹ is smaller, people have a lower level of literacy and are not able to file complicated tax returns, and tax authorities are not efficient in auditing and collecting taxes payable, a simple income tax system is demanded.¹² For

⁹ Progressive tax is a type of graduated tax which applies higher tax rates as the income of the taxpayer increases. See: Black H.C., *Black Law's Dictionary*, 6th ed. (St. Paul, Minn.: West Publishing Co., 1990) at 1212. A progressive tax, which is levied at 'graduated' rates, may be contrasted with a proportional tax, which is levied at a single 'flat' rate. Progressive tax rates are intended to produce vertical equity. Thus, the tax rate increases with increased income. The principle of 'vertical equity' implies that it is fair to require those with a greater capability to pay tax to bear relatively more of the tax burden. The rationale underlying vertical equity is the redistribution of the after-tax resources of all the taxpayers, and the different treatment is regarded as appropriate from the perspective of social welfare. Vertical equity implies that the greater equity can be achieved by utilizing the progressive rate mechanism. See: Osberg L., "What's Fair? The Problem of Equity in Taxation" in Head J.G. et al., (1993) *Fairness in Taxation* at 64. See also: Hogg P.W. & Magee J.E., *Principles of Canadian Income Tax Law*, 2nd ed. (Ontario: Carswell, 1997) at 57.

¹⁰ For the implications of the ability to pay principle, see: footnote 3 in chapter 1.

¹¹ There are two measures of income in a tax base, namely, income base and consumption base. The question of which measure of income in a tax base is more equitable has long been discussed. In Canada, a hybrid income tax base is utilized. For example, the income concept applies across a range of income sources, but the consumption principle is also visible in the concessions for retirement saving. See: Fried B.H., "Fairness and the Consumption Tax" (1992) 44 *Stanford Law Review* 961 at 999. See also: Osberg L., "What's Fair ? The Problem of Equity in Taxation" in Head J.G. et al (1993) *Fairness in Taxation* at 76. Retirement savings are intended to be saved for future consumption. The current tax treatment of Registered Retirement Savings Plan (RRSPs) goes part of the way to converting our income tax into a consumption tax. Analytically, with respect to the ability to pay principle, income tax is concerned with the theoretical justification for imposing a tax in the first place. That is to say, the income tax base is concerned with explicit wealth. On the contrary, the consumption base considers that the tax base shall be based on utilization rather than wealth. See: Fried B.H., "Fairness and the Consumption Tax" (1992) 44 *Stanford Law Review* 961 at 1000, 1015, 1016.

¹² See *supra* note 7 at 17. See also *supra* note 8 at 7.

example, when income tax was first effectively imposed in Greater China in 1936,¹³ average income was low and average people were illiterate, so Classified Income Tax was applied. In Taiwan, separated from China in 1949, and later in 1951, when the average income became higher, individuals whose income was 18,000 Yin-Yuan (the unit of currency circulated at that time) and more were subject to Consolidated Income Tax.¹⁴ G. Golm, a financial expert, has noted that the tax system should be developed and changed in accordance with a country's economic development and the implications for a country.¹⁵ The development of tax systems in the Greater China and Taiwan seems to prove Golm's theory.

Secondly, with Consolidated Income Tax, the individual includes all sources of income earned in one taxable year as his/her consolidated income, but can reduce it by deductions¹⁶ and exemptions,¹⁷ in accordance with the income tax law, which are exempt

¹³ After the Ching dynasty, the last empire in China's history, came to an end in 1912, income tax was first introduced in China in 1914. After that, civil war started in China, which made the imposition of income tax inefficient until 1936. Therefore, a commentator has noted that income tax in China effectively started in 1936. See *supra* note 7 at 6 - 7.

¹⁴ *Ibid.* at 7. See also *supra* note 8 at 7.

¹⁵ See *supra* note 7 at 5.

¹⁶ In Taiwan, the deductions applicable can be put into three categories 'Itemized deductions', 'Standard deductions' and 'Special deductions'. A taxpayer may select either the 'Standard deductions' or 'Itemized deductions' in taking a general deduction and may then take further 'Special deductions' while filing his/her tax return. In the Income Tax Law of Taiwan, 'Standard deductions' are NT\$38,000 (about Cd.\$1,900) for a single taxpayer, or NT.\$57,000 (about Cd.\$ 2,850) for a married couple. (In Taiwan, the tax paying unit applicable for marital couples, is basically the consumption unit system but simultaneously adopts the individual unit system for salary and wage income computation by the taxpayer's spouse. Therefore, for income tax of marital couples in Taiwan, one spouse, either husband or wife, can be the (major) taxpayer to file the tax return. However, for salary or wages earned by the taxpayer's spouse, the spouse can elect to have his/her income tax computed separately, and then declared and paid by the taxpayer when filing the joint tax return. That is to say, spouses should use the same tax return, regardless of whether the spouse of the taxpayer elects to have his/her salary or wage income tax

from income tax. Progressive tax rates are applied on the individual's net consolidated income.¹⁸ In addition, the income tax base in the Consolidated Income Tax is larger than

computed by utilizing the individual tax paying unit system or not.) See: paragraph 2, Article 17 of the income tax law of Taiwan.

However, the above amounts will be indexed every year, for example, in 1996, 'Standard deductions' are NT.\$42,000 (about Cd.\$2,100) for a single taxpayer, NT.\$63,000 (about Cd.\$3150) for a married couple. In 1997, 'Standard deductions' are NT.\$43,000 (about Cd.\$2150) for a single taxpayer, NT.\$65,000 (about Cd.\$3250) for a married couple. See *supra* note 7 at 49. See also: *General Income Tax Guide in Taiwan* (Ba Shie Liou Nian Du Zung Ho Suo De Shuei Jie Suan Shen Bau Shu, in Chinese), 1997.

The taxpayer's right of selection of either 'Standard deductions' or 'Itemized deductions' will be lost if the taxpayer who is required to file an income tax return (in accordance with Article 71 of the income tax law of Taiwan) but fails to do so and is assessed by the collection authority as to his/her tax liabilities. See: paragraph 3, Article 17 of the income tax law of Taiwan.

'Itemized deductions' may include the following: contributions and donations, insurance premiums, medical and maternity expenses, losses from disaster, and interest on a home mortgage. See: subparagraph 2, paragraph 1, Article 17 of the income tax law of Taiwan. 'Special deductions' are as the follows: losses from property transactions, specific deductions of income from salary/wages, specific deductions for savings and investment, and the special deduction for the disabled or handicapped. See: subparagraph 2, paragraph 1, Article 17 of the income tax law of Taiwan.

¹⁷ In Taiwan, a taxpayer may deduct an exemption for himself/herself according to subparagraph 1, paragraph 1, Article 17 of the income tax law of Taiwan. However, in Taiwan, the tax paying unit applicable for marital couples, is basically the consumption unit system, but simultaneously adopts the individual unit system for salary and wage income computation of the taxpayer's spouse. In addition, the married couple in Taiwan shall use the same tax return, regardless of whether the spouse of the taxpayer elects to have his/her salary or wage income tax computed by utilizing the individual tax paying unit system or not, according to paragraph 2, Article 15 of the income tax law of Taiwan. In this circumstance, the major taxpayer may deduct exemptions for himself/herself, his/her spouse and dependents conforming to any of the following requirements,....

(1) Lineal ascendants of the taxpayer and his/her spouse having attained sixty years of age, or being incapable of earning a livelihood and being supported by the taxpayer. If the lineal ascendant has attained seventy years of age, the exemption is increased by 50%.

(2) Children of the taxpayer under twenty years of age, or twenty years of age or over and are supported by the taxpayer by reason of school attendance, or by physical or mental disability, or being incapable of earning a livelihood.

(3) Brothers and sisters of the taxpayer under twenty years of age, or twenty years of age or over and are supported by the taxpayer by reason of school attendance, or by physical or mental disability, or being incapable of earning a livelihood.

(4) Other relatives or family members of the taxpayer within the meaning of subparagraph 4, Article 1114, or paragraph 3, Article 1123, of the Civil Code under twenty years of age or having attained sixty years of age who are incapable of earning a livelihood and supported by the taxpayer. In 1997, the exemptions applicable with respect to the aforesaid dependents are: (1) NT.\$108,000 (about Cd. 5,400) for lineal ascendants of the taxpayer and his/her spouse having attained seventy years of age. (2) NT.\$72,000 (about Cd.\$ 3600) for taxpayer himself/herself, his/her spouse, and the other dependents mentioned above. See: subparagraph 1, paragraph 1, Article 17 of the Taiwan Income Tax Law, MOEA (1995) at 32-33. See also: *General Income Tax Guide in Taiwan* (Ba Shie Liou Nian Du Zung Ho Suo De Shuei Jie Suan Shen Bau Shu, in Chinese), 1997.

¹⁸ In Taiwan, the net consolidated income of an individual shall be the gross consolidated income less the deductions and exemptions. See: Article 17 of the Income Tax Act of Taiwan, MOEA (1995) at 32-39.

that in the Classified Income Tax. In the Consolidated Income Tax, except for the amount of income that is deductible or exempted from income inclusion, all income earned or gained by an individual shall be declared in the tax return and be subject to tax. Compared to the Classified Income Tax, where tax is only imposed on sources of income listed in the income tax law, the income tax base in the Consolidated Income Tax is larger.

Furthermore, since progressive tax rates are applied on the net consolidated income, the ability to pay principle in the tax policy regime is satisfied. However, there is also weakness in the Consolidated Income Tax -- it is the individual's obligation to file his/her tax return. In cases where the individual deliberately engages in inappropriate tax avoidance, the country will often suffer revenue loss due to the inadequacy of auditing techniques.¹⁹

Thirdly, the Classified and Consolidated Income Tax is a blend of the Classified Income Tax and the Consolidated Income Tax.²⁰ The Classified and Consolidated Income Tax taxes any individual on his/her different sources of income, which is identical to the Classified Income Tax. However, should an individual's income earned in one taxable year be over a certain amount, the individual will also be subject to Consolidated Income Tax.²¹ In order to avoid the drawbacks in the Classified Income Tax system such as the fact that it does not take into account the deductions and exemptions applicable to an

¹⁹ See *supra* note 7 at 17 - 19.

²⁰ See *supra* note 8 at 7.

²¹ *Ibid.* See also *supra* note 7 at 18-19.

individual and that it does not satisfy the principle of ability to pay, the Classified and Consolidated Income Tax adjusts the Classified Income Tax by applying progressive tax rates on an individual's consolidated income, where the income earned in one taxable year is over a certain amount. Otherwise, the tax applicable is identical to that in the Classified Income Tax.²²

One commentator has stated that the Consolidated Income Tax emphasizes the taxpayer's total amount of income earned in one taxable year, without taking into account his/her different sources of income.²³ On the contrary, the Classified Income Tax emphasizes different sources of income but not the taxpayer's total amount of income earned in one taxable year.²⁴ In other words, the Consolidated Income Tax emphasizes the equal distribution of tax liability of all the taxpayers, whereas, the Classified Income Tax emphasizes equal treatment of all sources of income.²⁵ The Classified and Consolidated Income Tax system is a transition from the Classified Income Tax to the Consolidated Income Tax.²⁶ In order to achieve the principle of ability to pay, the Consolidated Income Tax should be applied. In this situation, the taxpayers should be able to file tax returns by self-assessment and then be taxed by the progressive tax rates. The Consolidated Income Tax system can be applicable where the economic and living

²² See *supra* note 7 at 17-19.

²³ See *supra* note 8 at 7.

²⁴ *Ibid.*

²⁵ *Ibid.*

²⁶ *Ibid.*

standards are more sophisticated. However, if a developing country is in transition and the Consolidated Income Tax system is not yet appropriate, the Classified and Consolidated Income Tax system can be a choice.²⁷

2.1.3 The Personal Income Tax System Used in Taiwan

The Consolidated Income Tax is utilized in Taiwan. Since the connecting factor that subjects the individuals in Taiwan to tax is domestic source income, any individual whose consolidated income is received in or earned from Taiwan sources is subject to income tax in Taiwan.

2.2 Residence -- Principal Connecting Factor in Canada

2.2.1 Concept of Residence

Residence is vitally important in Canadian taxation, because income tax liability in Canada is based on residence, in conjunction with source of income.²⁸ Canadian residents

²⁷ *Ibid.*

²⁸ Subsections 2(1) and 2(3) of the *Act* provide:

2(1) **[Tax payable by persons resident in Canada]** -- An income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in the year.

2(3) **[Tax payable by non-resident persons]** -- Where a person who is not taxable under subsection (1) for a taxation year (a) was employed in Canada, (b) carried on a business in Canada, or (c) disposed of a taxable Canadian property, at anytime in the year or a previous year, an income tax shall be paid, as required by this Act, on the person's taxable income earned in Canada for the year determined in accordance with Division D.

are taxable on their worldwide income, and non-residents on income derived from sources and certain activities (e.g.: carrying on business in Canada²⁹) in Canada.³⁰

These provisions make it quite clear that a resident of Canada is liable for tax on his/her *worldwide income* for any year in which he/she is a resident *at any time* in Canada.³¹ A non-resident, on the other hand, is only liable on amounts earned or produced from employment in Canada, business in Canada or dispositions of taxable Canadian property and Part XIII tax (i.e.: interest, dividends etc.).³² The distinction is evident. The potentially wide impact and harshness of subsection 2(1) is mitigated by the part-time resident provisions in section 114, under which an individual not employed or carrying on business for the remainder, is only taxed as a resident for that portion of the year during which he/she was a resident.³³

One rationale and advantage of using residence as a base for the ability to pay is that '[residence] ... produces the largest class of taxpayers with strong social and economic ties with the country; they are all people with a moral obligation to finance the government;

²⁹ See: subsection 2(3) of the *Act*.

³⁰ See: subsections 2(1) and 2(3) of the *Act*.

³¹ Hansen B.G., "Individual Residence" in *Report of the Proceedings of the Twenty-ninth Tax Conference, 1977* (Toronto: Canadian Tax Foundation, 1978), 682 at 684.

³² See: section 2(3) and Part XIII of the *Act*. See also: *Canada Income Tax Regulations Service*, vol. 1 (Toronto: Richard De Boo, 1982) at 13-1, 13-2. See also: Krishna V., *The Fundamentals of Canadian Income Tax*, 5th. ed. (Toronto: Carswell, 1995) at 122 - 124.

³³ See *supra* note 31 at 684.

and they are all people against whom enforcement is practicable'.³⁴ Residence is probably regarded in the literature³⁵ as the best of all the alternatives, namely: source, citizenship, residence, and domicile in determining who shall be subject to tax. Although the taxation of a resident alien (who cannot vote) can be criticized as 'taxation without representation', and the concept of residence (as we shall see) is far from precise,³⁶ residence is still the connecting factor utilized in Canada and by the model treaties³⁷ in determining who is subject to tax and which country has the authority to tax. 'Residence can be described as being closer in relationship with a country than citizenship but not as close as domicile'³⁸ ... in short, in degree of association with the country concerned, the concept of residence generally stands between citizenship and domicile³⁹.

³⁴ Hogg P.W. & Magee J.E., *Principles of Canadian Income Tax Law*, 2nd ed. (Ontario: Carswell, 1997) at 111.

³⁵ *Ibid.*

³⁶ *Ibid.* In addition, Rand, J. in *Thomson v. M.N.R.* [1946] C.T.C. 51, 2 D.T.C. 812 (S.C.C.) said: 'The gradation of degree of time, object, intention, continuity and other relevant circumstances shows, I think, that in common parlance 'residing' is not a term of invariable elements, all of which must be satisfied in each instance. It is quite impossible to give it a precise and inclusive definition. It is highly flexible, and its many shades of meaning vary not only in the contexts of different matters, but also in different aspects of the same matter. In one case it is satisfied by certain elements, in another by others, some common, some new.'

³⁷ See article 4 of the OECD, the U.N. and the U.S. model treaties.

³⁸ 'Domicile of choice involves two main elements: a fact of presence within the jurisdiction and present intention on the part of the individual to maintain a permanent home in the jurisdiction'. See: Arnold B.J., Edgar, T. & Sandler D., *Canadian Income Tax*, 11th ed. (Ontario: Carswell, 1996) at 154. See also: *Udny v. Udny* (1869) L.R.I. Sc. & Div. 441, at 458. Lord Westbury noted in *Udny v. Udny*: '[d]omicile of choice is a conclusion or inference which the law derives from the fact of a man fixing voluntarily his sole or chief residence in a particular place with an intention of continuing to reside there for an unlimited time'.

³⁹ See: Arnold B.J., Edgar, T. & Sandler D., *Canadian Income Tax*, 11th ed. (Ontario: Carswell, 1996) at 154.

2.2.2 Definition of Residence -- The Case Law

(1) Residence

There is no statutory definition of 'residence' provided in the *Act*. Paragraph 2 of the Interpretation Bulletin IT-221R2 states: '[t]he term "resident" is not defined in the income Tax Act. The courts have held that an individual is resident in Canada for tax purposes if Canada is the place where he, in the settled routine of his life, regularly, normally or customarily lives. In making this determination, all of the relevant facts in each case must be considered.'⁴⁰ The case law has held that residence is a question of fact, to be determined on the facts of each case.⁴¹ Thorson, P. in *Thomson v. M.N.R.*⁴² said: '[t]he cases ... really carry one no further than the dictionary, and, in the main, are but useful illustrations of the circumstances under which a person may be considered as residing or ordinarily resident in a place or country'⁴³.

Since residence is a question of fact, to be determined on the facts of each case, the question is: '[w]hat are the determinant factors to be taken into account with respect to residence?' In *Denis M. Lee v. M.N.R.*,⁴⁴ the court listed a number of factors⁴⁵ which,

⁴⁰ See: paragraph 2 of the Interpretation Bulletin IT-221R2.

⁴¹ See: *Thomson v. M.N.R.* [1946] C.T.C. 51, 2 D.T.C. 812 (S.C.C.), the judgment was referred to in other cases, for example: *Denis M. Lee v. M.N.R.* [1990] 1 C.T.C. 2082, 90 D.T.C. 1014 (T.C.C.)

⁴² *Thomson v. M.N.R.* [1945] C.T.C. 63 at 73 (Exch. Ct.).

⁴³ See *supra* note 39 at 155.

⁴⁴ *Denis M. Lee v. M.N.R.* [1990] 1 C.T.C. 2082, 90 D.T.C. 1014 (T.C.C.).

considered together,⁴⁶ could establish that the individual is a resident of Canada for Canadian income tax purposes. Moreover, in Interpretation Bulletin IT-221R2, there are some analytical factors, namely, (a) permanence and purpose of stay abroad,⁴⁷ (b) residential ties within Canada, (c) residential ties elsewhere, and (d) regularity and length of visits to Canada, used in determining an individual's residence status. It can be

⁴⁵ The factors include: past and present habits of life; regularity and length of visits in the jurisdiction asserting residence; ties within the jurisdiction; ties elsewhere; permanence or otherwise of purposes of stay; ownership of a dwelling in Canada or rental of a dwelling on a long-term basis (for example, a lease for one or more years); residence of spouse, children and other dependent family members in a dwelling maintained by the individual in Canada; memberships with Canadian churches or synagogues, recreational and social clubs, unions and professional organizations; registration and maintenance of automobiles, boats and airplanes in Canada; holding credit cards issued by Canadian financial institutions and other commercial entities including stores, car rental agencies, etc.; local newspaper subscriptions sent to a Canadian address; rental of Canadian safe deposit box or post office box; subscriptions for life or general insurance including health insurance through a Canadian insurance company; mailing address in Canada; stationery including business cards showing a Canadian address; magazine and other periodical subscriptions sent to a Canadian address; Canadian bank accounts other than a non-resident bank account; active securities accounts with Canadian brokers; Canadian driver's license; membership in a Canadian pension plan; holding directorship of Canadian corporations; membership in Canadian partnerships; frequent visits to Canada for social or business purposes; burial plot in Canada; will prepared in Canada; legal documentation indicating Canadian residence; filing a Canadian income tax return as a Canadian resident; ownership of a Canadian vacation property; active involvement in business activities in Canada; employment in Canada; maintenance or storage in Canada of personal belongings including clothing, furniture, family pets, etc.; obtaining landed immigrant status or appropriate work permits in Canada; and severing substantially all ties with former country of residence.

⁴⁶ Some factors will be of less or no meaning at all without being considered together. For example, 'memberships with Canadian churches or synagogues, recreational and social club', 'burial plot in Canada', etc.. Therefore, these factors tends to be regarded as supplementary factors, which cannot be independently utilized for the determination of residency.

⁴⁷ In respect of this, the 'Two Years Rule' was instituted by the Department of National Revenue in Interpretation Bulletin IT-221R2. It means where a Canadian resident is absent from Canada (for whatever reason) for less than 2 years, he/she will be presumed to have retained his/her residence status while abroad, unless he/she can clearly establish that he severed all residential ties on leaving Canada. Furthermore, the Department held that if there is evidence that an individual's return to Canada was foreseen at the time of his/her departure (e.g., a contract for employment upon return to Canada), the Department will presume that he/she did not sever all residential ties on leaving Canada. In other words, the Department held that in order for an individual to become a non-resident of Canada, there must be a degree of permanence to his stay abroad.

See: paragraph 4 of the Interpretation Bulletin IT-221R2. See also: paragraphs 5 to 12 of the Bulletin, in which, the Department declares that where an individual is absent from Canada for 2 years or longer, he/she will be presumed to have become a non-resident of Canada, provided that he satisfies the other requirements for non-resident status outlined in paragraphs 6 to 12 of the Bulletin. These paragraphs are concerned with the other factors with respect to the determination of residence status, namely, 'residential ties within Canada', 'residential ties elsewhere', and 'regularity and length of visits to Canada'.

concluded that the determination of residence is based on a series of facts; intention,⁴⁸ or free choice is not an essential element in determination of residence. As Teskey, T.C.J. indicated in *Denis M. Lee v. M.N.R.*: '[i]ntention, or free choice, is an essential element in domicile, but is entirely absent in residence'.⁴⁹ However, even though the listed factors are intended to help determine the question of residency, some of the criteria are still very

⁴⁸ Brian G. Hansen in *supra* note 31 said: 'It has always been clearly established that there is a marked difference between residence and domicile. The latter is dependent on the volition of the individual.' See *supra* note 31 at 699. However, two cases in the early 1970s, namely, *Kallos v. M.N.R.* [1972] C.T.C. 2100 and *Kirby v. M.N.R.* [1972] C.T.C. 2101, the Tax Review Board appeared to move very far in making domicile and residence synonymous. Mr. Frost of the Board in *Kallos v. M.N.R.* held that the taxpayer had given up his residence. His conclusion was based on the fact that the taxpayer *intended* to move to the U.S.A. and that he had no *intention* of returning to Canada. In *Kirby v. M.N.R.*, also decided by Mr. Frost, Mr. Frost found that the taxpayer was still a resident of Canada, saying that 'change of resident requires some evidence of the *intention* of the appellant to become permanently resident in another country'. Brian G. Hansen commented on these two judgments saying: 'This focusing on the intention of the taxpayer is clearly incorrect. A taxpayer may acquire residence in another country without any intention to do so; an extreme example would be where there is a political upheaval and no one is permitted to leave the country for a period of two years. If the taxpayer lives and works there he may very well be resident, despite his desire to leave. This is not to say that the taxpayer's intention is disregarded by the courts; obviously, if a taxpayer ceases to be resident he will normally intend to leave the country. But the conclusion should be reached by a review of surrounding factors rather than the taxpayer's own wishes.' See *supra* note 31 at 699 - 700. After the two cases, the Tax Review Board reiterated the traditional distinction between domicile and residence. An excellent example of the uselessness of intention can be found in the decision in *Luks v. M.N.R.* 64 D.T.C. 444. The point was well made by Gwyneth McGregor: 'In a sense, of course, it may be said that the tests used by the courts to determine residence make indirect use of the intention factor ... but it is not that intention per se that determines whether or not he was resident but his actions; the tests are objective, not subjective.' See: McGregor G., "Around the Courts" (1972) 20 Canadian Tax Journal 115 at 127. See also: *supra* note 31 at 700. More recently, in *Denis M. Lee v. M.N.R.* [1990] 1 C.T.C. 2082, 90 D.T.C. 1014 (T.C.C.), again, the appellant's intention was not the consideration of the court, even though the appellant kept on saying that he had no intention to be a resident in Canada during the questioned period. For example: 'I wouldn't call it (Canada) a home' and 'In my definition I didn't reside here (Canada). I was not allowed to do any of the things that I would regard as normal for a resident of an area...'

⁴⁹ What is interesting in *Denis M. Lee v. M.N.R.* [1990] 1 C.T.C. 2082, 90 D.T.C. 1014 (T.C.C.) is that the judgment held that '[a]lthough marriage can be a neutral factor, in this case it is the additional factor that tips the scales from one of the non-residency to one of residency'. In respect of this, it can be concluded that the factors used for the determination of residency will have different weight depending on the different situations of each case.

ambiguous⁵⁰ and need to be implemented by the judgment of each case, which can be very subjective.

The issue of what constitutes residence has certainly been an increasing concern for Canadian taxpayers. It is evident that Revenue Canada has made an effort to clarify the factors regarding the determination of resident. For example, in comparison of Interpretation Bulletins IT-221⁵¹ and IT-221R2, Interpretation Bulletin IT-221R2 is more able to explain and solve the residence complexity in practice. The problem with Interpretation Bulletin IT-221 was that it only contemplated the easy case. For example, it is well known that leaving Canada for a holiday or health reasons will not amount to giving up residence. Likewise, leaving a fully contained house will normally lead to the same result.⁵² Interpretation Bulletin IT-221 explained that, under these situations, the individual is still regarded as resident in Canada. In other words, Interpretation Bulletin IT-221 did not provide much help in solving the mass of factual complexities arising in most residence cases.⁵³ In addition, Interpretation Bulletin IT-221 'was solely concerned

⁵⁰ For example: for the factor, 'frequent visits to Canada for social or business purposes', what number of visits constitute 'frequent'? The answer will depend on the judgment of each case, different judges may have different conclusions. In addition, the factors such as: 'ties within the jurisdiction', 'ties elsewhere' are hollow, unless supplemented by other facts provided, for example: in paragraphs 6 & 10, IT-221R2, have no substantial meaning. Moreover, Rand J. in *Thomson v. M.N.R.* said: '... The enquiry lies between the certainty of fixed and sole residence and the uncertain line that separates it from occasional or casual presence, the line of contrast with what is understood by the words 'stay' or 'visit' into which residence can become attenuated; and the difference may frequently be more a matter of sensing than a clear differentiation of factors.' See also *supra* note 31 at 689-690.

⁵¹ Interpretation Bulletin IT-221, dealing with the determination of residence for individuals leaving Canada, was issued on May 26, 1975. IT-221 was replaced by IT-221R dated May 26, 1980 and then IT-221R2 dated February 20, 1991.

⁵² See *supra* note 31 at 700 - 701.

⁵³ *Ibid.*

with residential ties. It makes no attempt to rationalize continuing social or business interests'.⁵⁴ On the contrary, paragraph 9 of the Interpretation Bulletin IT-221R2, not only listed social ties (e.g. resident club memberships etc.), but also listed other ties that may also be relevant in the determination of resident, including: (a) provincial hospitalization and medical insurance coverage, (b) a seasonal residence in Canada, (c) professional or other memberships in Canada (on a resident basis), and (d) family allowance payment. However, even in the more elaborate Interpretation Bulletin IT-221R2, there is still some over generalization to be clarified to make the criteria more practical. For example, with respect to 'residential ties within Canada', in paragraph 7 of the Interpretation Bulletin IT-221R2, it says: '[an] individual who leaves Canada, but ensures that a dwelling place suitable for year round occupancy is kept available in Canada for his occupation by maintaining it (vacant or otherwise), by leasing it at non-arms length, or by leasing it at arm's length with the right to terminate the lease on short notice (less than 3 months) will "generally" be considered not to have severed his residential ties within Canada'. Therefore, the individual will be regarded as a resident of Canada and will be subject to tax. It is true that the Department says 'generally', but they do not say when the exceptional case will arise.⁵⁵ On the other hand, one might ask why the Department thinks that leaving a house on short notice is indicative of a retention of residence. There might be numerous reasons for a short notice period, not the least being

⁵⁴ See *supra* note 31 at 701.

⁵⁵ The Department said 'normally' in IT-221. In IT-221R2, the word 'normally' was replaced by 'generally', but it does not seem to increase its substantive value.

a desire to sell the property in the near future⁵⁶. These problems make the Bulletin lack substantial value as a tool by which to definitively determine whether or not a taxpayer is resident in Canada.

In terms of the degree of 'closeness' that an individual has with a country, 'resident' can be classified into several categories as follows.

(1.1) Deemed Resident:

Section 250(1) of the Canadian Income Tax Act says:

[Person deemed resident] -- For the purposes of this Act, a person shall, subject to subsection (2), be deemed to have been resident in Canada throughout a taxation year if the person

- (a) sojourned⁵⁷ in Canada in the year for a period of, or periods the total of which is, 183 days or more;
- (b) was, at any time in the year, a member of the Canadian Forces;

⁵⁶ See *supra* note 31 at 701.

⁵⁷ The word 'sojourn' is defined in the *Random House Dictionary* as 'to stay for a time in a place, live temporarily' and in the *Shorter Oxford Dictionary* as 'to make a temporary stay in a place, to remain or reside for a time'; *Webster's Dictionary* defines the noun as 'a temporary stay as of a traveler in a foreign land'. In practice, Estey, J. in *Thomson v. M.N.R.* [1946] C.T.C. 51, 2 D.T.C. 812 (S.C.C.) said: 'One "sojourns" at a place where he unusually, casually or intermittently visits or stays.' Notwithstanding that one must be physically present to be a sojourner, he also pointed out that in 'sojourn', there is an element of the temporary. In the same case, Rand, J. said: 'I would ... treat the word "sojourns" as applying to presence in Canada where the nature of the stay is either outside the range of residence or is what is commonly understood as temporary residence or residence for a temporary purpose'. And, Kellock, J., pointed out that a 'mere sojourn' was not within the residence provision 'unless the sojourn continues beyond the stated period'. See also: McGregor G. "Deemed Residence" (1974) 22 Canadian Tax Journal 381 at 386. On the contrary, staying without an element of the temporary, in other words, not in a sense of living there temporarily, does not constitute 'sojourning'. See: the Tax Review Board decision in *R & L Food Distributors Limited v. M.N.R.* [1977] C.T.C. 2579 (T.R.B.). In this case, the majority shareholders of an Ontario corporation had their homes in the Detroit area and commuted to Windsor to work about 300 days each year. The shareholders stayed overnight in Canada only six or seven times a year and then only in the course of business trips. The individuals had no accommodation available to them in Canada and all personal and social connections were in the United States. The taxpayer corporation claimed the small business deduction on the basis that it was controlled by Canadian residents. The appeal was dismissed. The Board held that the shareholders' course of action was not tantamount to making a temporary stay in Canada and was not sojourning. See also: Morris D. B., "Jurisdiction To Tax: An Up-Date" (1979) Report of Proceedings of the Thirty-first Tax Conference 414 at 420.

- (c) was, at any time in the year,
 - (i) an ambassador, minister, high commissioner, officer, or servant of Canada, or
 - (ii) an agent-general, officer or servant of a province.
 and was resident in Canada immediately prior to appointment or employment by Canada or the province or received representation allowances in respect of the year;
- (d) performed services, at any time in the year, in a country other than Canada under a prescribed international development assistance program of the Government of Canada and was resident in Canada at any time in the 3 months period preceding the day on which those services commenced;
- (d.1) was, at any time in the year, a member of the overseas Canadian Forces school staff who filed his or her return for the year on the basis that the person was resident in Canada throughout the period during which the person was such a member;
- (e) was resident in Canada in any previous year and was, at any time in the year, the spouse of a person described in paragraph (b), (c), (d) or (d.1) living with that person, or
- (f) was at any time in the year a child of, and dependent for support on, an individual to whom paragraph (b), (c), (d) or (d.1) applies and the person's income for the year did not exceed the amount used for the year under paragraph (c) of the description of B in subsection 118(1).

The rationale of these provisions, according to Brian G. Hansen, is quite clear;

'[p]aragraph 250(1)(a) is designed to deal with individuals who devote a substantial period of their time in any one year to transient stays in Canada, but who would not satisfy the common criteria for residence'.⁵⁸ A person's residence under common law rule is, broadly speaking, the country (or countries, since an individual may have more than one residence)⁵⁹ where he has a family, a house or other ties and where he/she lives as part of his/her normal course of life. A person must have a residence somewhere but a fixed place of abode is not essential,⁶⁰ since even a homeless tramp is a resident of some country; and

⁵⁸ See *supra* note 31 at 683.

⁵⁹ *Lloyd v. Sully* (1884) 2 T.C. 37.

⁶⁰ *Reid v. C.I.R.* (1926) 10 T.C. 673.

constant physical presence is not necessary to residence, so that a person may continue to be resident while physically absent.⁶¹ 'Presumably the government's [intention] enacting paragraph 250(1)(a) is that someone who even temporarily devotes six months or more of his/her life to Canada in a year should be treated as falling within the tax jurisdiction of this country⁶²'. However, Brian G. Hansen comments on the rationale saying: '[i]t is difficult to argue with this philosophy, but the consequences of such deemed residence may not be justified. Of particular concern is the fact that the individuals that the section was intended to catch, i.e. people like Thomson,⁶³ receive professional advice and never stay in the country 183 days. It is the poorer unsuspecting taxpayer who is caught and one wonders why the Department is even interested in such persons⁶⁴'.

Comments and questions may also arise as to why Canada treats sojourners so much more harshly than part-time Canadian residents, whose tax burden can be alleviated by employing section 114 of the *Act*. Why should a non-resident who is deemed to be a resident because he/she happens to be in Canada for 184 days in a year be taxed on his

⁶¹ See: McGregor G., "Deemed Residence" (1974) 22 Canadian Tax Journal 381 at 381.

⁶² See *supra* note 31 at 683.

⁶³ The definition of the word 'sojourn' was considered at some length in the classic case of *Thomson v. M.N.R.* [1946] C.T.C. 51, 2 D.T.C. 812 (S.C.C.). The taxpayer had left Canada in 1923 and rented a house in Bermuda but spent only a few days there each year. In 1939 he built a home in Pinehurst, N.C., and moved his belongings there from Canada, and in the following years he spent periods of from 134 to 169 days in Canada, first in a rented house then in a house which he built in New Brunswick and in which he kept servants all the year round. In 1941 he was asked to file a Canadian tax return; he refused, was assessed on an arbitrary figure of \$50,000 a year and appealed. He contended that he was not ordinarily resident in Canada under paragraph (a) of section 9, but merely sojourned in Canada for fewer than 183 days in each year. Since mere sojourn was not within the residence provision unless the sojourn continues beyond 183 days, so, he contended that he was therefore not taxable.

⁶⁴ See *supra* note 31 at 683.

worldwide income for the whole year, while a Canadian resident who is here for the same length of time is taxed in Canada on his/her worldwide income only for the period during which he/she was in the country? According to Gwyneth McGregor, it is not at all clear why and also no logical reason for this discrimination presents itself.⁶⁵ 'A resident of a country pays taxes in order that the country may have money to run itself and to provide services for its people. But a sojourner does not avail himself of those services any more than the part-time resident -- in fact, probably he uses them less, since he is not likely for example, to own a house or have children attending school. Possibly one must fall back on that old unsatisfactory reason for so many things -- administrative convenience. But since the authorities must in any event check on a sojourner to see whether he has passed the 183 day⁶⁶ mark, would it really be so much more trouble to check on the total of days he was in the country, and tax him on that proportion of 365, giving the proportionate personal allowances⁶⁷?

⁶⁵ See *supra* note 61 at 390.

⁶⁶ What is a 'Day' in the context of subsection 250(1)(a) of the *Act* since deemed residence may hinge upon the number of days spent in Canada? The fast answer that most people would give to that question would be '24 hours', but this is not so for the purpose of determining whether a person has sojourned here for 183 days. According to Department of National Revenue, its interpretation of the word 'day' is 'that any day in the year on which a person was physically present in Canada will count as one day without regard for the number of hours in that day that he was here.' For example, in the classic case, *Wiskie v. C.I.R.* 32 T.C. 495, the question was whether the days of arrival in and departure from the U.K. were to be counted as full days in determining whether the taxpayer had spent six calendar months there. If those days were counted as full days, he spent 184 days there, but if only the hours spent in the country were counted they were fewer than the number of hours in six months. The Crown contended that a *fraction* of a day should count as a whole day and referred to this as 'an established rule of law'. See *supra* note 61 at 387 - 388.

⁶⁷ *Ibid.* at 390.

As mentioned, the difference in the treatment of a person who was resident in Canada for only part of a year, and a sojourner who spends only part of a year in Canada, is that the Canadian resident who leaves Canada during the year, whether his/her stay in Canada has been longer or shorter than 183 days, is treated as a resident up to the time of his/her departure and as a non-resident thereafter, and is subject to tax under section 114 of the *Act* as a part-time resident. This means that he/she is taxable on his/her worldwide income and capital gains only for the period during which he/she was resident in Canada, and receives a *pro rata* deduction for personal allowances. The sojourner, on the other hand, is taxable only as a non-resident, under subsections 2(3) and 115(1), on income earned in Canada or received from the disposition of taxable Canadian property, if he/she sojourns for less than 183 days, but is taxable on his/her worldwide income for the whole taxation year as a 'deemed resident', under paragraph (a) of subsection 250(1) of the *Act*, if he/she stays for longer than 183 days.⁶⁸ Thus, it can be concluded that the interrelationship of subsection 250(1)(a) and section 114 is that section 114 can have no operation to subsection 250(1)(a). The departmental position on the applicability of subsection 250(1) generally to section 114 was outlined in Interpretation Bulletin IT-193, which dealt with part-time residents. Paragraph 3 states that the Bulletin does not apply to taxpayers who have been deemed resident by subsection 250(1). Again, in Interpretation Bulletin IT-221, dealing with the determination of 'giving up residence', it states that a person deemed resident by section 250(1) is an exception to the general rules. Brian G. Hansen said: '[t]here can be no doubt that the Department's position is correct. Subsection 250(1)

⁶⁸ *Ibid.*

deems taxpayers to be resident for the *whole* of the year. Accordingly, section 114 can have no operation, since it only applies to part-time residents. Why this result follows is unclear. I do not know whether it causes problems for taxpayers; in some cases the treaty provisions may assist, in others the foreign tax credit will solve many problems. However, it does seem unnecessary discrimination against the sojourner⁶⁹.

As far as the other parts of subsection 250(1), i.e. subsections 250(1)(b) to (f), are concerned, the general philosophy is evidently that those employed by the Government of Canada or a province thereof, or performing services on its behalf in an assistance program, i.e. Canadian Abroad, should be treated as though they were working in Canada. Many or most of them may have their homes and families, and all their ties, in the countries where they are serving, and under the common law rules they would be non-residents of Canada during the time they stayed abroad. These provisions of the *Act*, however, make them residents of Canada even though they may not actually set foot in the country during the year.⁷⁰ Nevertheless, the question may arise of whether individuals performing services abroad for federal or provincial Crown Corporations fall within the provisions of subsection 250 (1). The question was dealt with in some length in the Department of National Revenue's Interpretation Bulletin IT-106, published June 4, 1973. This Bulletin deals with the tax status of Crown corporation employees. The essential

⁶⁹ See *supra* note 31 at 706.

⁷⁰ See *supra* note 61 at 382 - 383.

issue is whether such employees are officers and servants of Canada. Paragraph 3 of the Bulletin states:

3. the term 'officer or servant of Canada', or 'officer or servant of a province' includes any officer or employee of a federal or provincial Crown Corporation or agency if, in the statute under which it is organized or established, its officers and employees are given the status of servants of Her Majesty or are designated as being part of the public service of Canada or the province. If the Corporation or agency is designated as an agent of Her Majesty without specific mention being made as to the status of its employees, they will be assumed to be officers or servants of Canada or a province, as the case may be.⁷¹

There are two cases which can exemplify this type of situation. In *Stachan v. The Queen*,⁷² a professional engineer employed by Atomic Energy of Canada Ltd. was transferred to a post in India in June, 1971. The Minister assessed him for 1971 on the basis that he was an officer or servant of Canada and so deemed to be resident. The Federal Court-Trial Division upheld the assessment, on the grounds that according to the Atomic Energy Control Act the company employing the taxpayer was a servant or agent of the Crown, and it therefore followed that all its employees were employees of the Crown.⁷³ Therefore, the Federal Court held that the essential question with respect to Crown corporations was whether the corporation was acting on its own behalf or whether it was acting as an agent of the Crown. If the latter was the case, then any employees hired were also officers and servants of the Crown. In this case, this was the proper status of the employees of Atomic Energy of Canada.⁷⁴ The other example was in *Peterson v.*

⁷¹ *Ibid.* at 383.

⁷² *Stachan v. The Queen* 73 D.T.C. 5343; [1973] C.T.C.

⁷³ See *supra* note 61 at 383.

⁷⁴ See *supra* note 31 at 707.

*M.N.R.*⁷⁵ The appellant was an engineer who in October, 1964 signed a contract with a construction company to work on a project in Burma which came under the Colombo Plan. He then went to Burma, where in January, 1966 he signed a second contract which ran continuously from the expiration of the first until the assignment was completed. He returned to Canada late in December, 1966, and contended that he was not taxable on his 1966 income, on the grounds that (1) that his services in Burma were not performed for his regular employer but for a firm of consultants to whom he had been loaned; and (2) that he had signed two separate contracts and had not been resident in Canada for three months, as required by paragraph (d), before the day his services began under the second. The appeal was dismissed on both counts; the services were performed under the prescribed program in any event, and his employment had been continuous and should not be divided into two separate employments.⁷⁶

However, if a person who is an officer or servant referred to in the provisions aforesaid, ceases to be so while he/she is abroad, and then remains abroad for the whole year, subsection 250 (2) of the *Act* provides that he/she is deemed to be have been resident in Canada during that part of the year preceding that time. After that time it is a question of fact whether he/she was or was not a resident under the common rules, and if he/she is not, he/she would be treated like any part-time resident under section 114 of the *Act*.

⁷⁵ *Peterson v. M.N.R.* 69 D.T.C. 503; [1969] Tax ABC 682.

⁷⁶ See *supra* note 61 at 383.

Subsection 250 (1) is very wide in ambit, so, to some extent, these provisions are complementary to other provisions in the *Act* and treaties. In the *Act*, for example, subsection 149(1)(a) exempts from Canadian tax employees of foreign governments and their families in circumstances largely reciprocal to subsection 250(1)(c).⁷⁷ For example, subparagraph (c), Article 4 of the 1996 United States Model Income Tax Convention, refers to 'residence' saying that: '[a] qualified governmental entity is to be treated as a resident of the Contracting State where it is established'⁷⁸. As the commentary of the model treaty said: '[s]ubparagraph (c) specifies that a qualified governmental entity (as defined in Article 3) is to be treated as a resident of that State. Although this provision is not contained in previous U.S. Models, it is generally understood that such entities are to be treated as residents under all of those model treaties. The purpose of including the rule in the Model is to make this understanding explicit. Article 4 of the OECD Model was amended in 1995 to adopt a similar approach'⁷⁹.

The final provisions of the *Act* relating to deemed residence are those in subsections 212(13.1) and (13.2). These provisions, added in 1974, extend the withholding tax to payments made to and by non-residents. Under paragraph 212(13.1)(a) any partnership making a payment to a non-resident is deemed to be resident and thus subject to the Part XIII requirements. Subsection 212(13.2) operates when a non-resident person who

⁷⁷ See *supra* note 31 at 684.

⁷⁸ Diamond W.H., Diamond D.B., Overseas Press and Consultants, ed., *International Tax Treaties Of All Nations* vol. XL Series B (New York: Oceana Publications, Inc., 1997) at 360.

⁷⁹ *Ibid.* at 424.

carries on a business principally in Canada or manufactures or processes goods in Canada, operates an oil or gas well in Canada or extracts minerals from a mineral resource in Canada. If any such person pays or credits certain amounts to another non-resident person and that amount would be deductible in computing the taxable income of the payer, then such person will be deemed to be resident in Canada.⁸⁰

(1.2) Ordinarily Resident

Subsection 250(3) of the *Act* states that a reference to a person resident in Canada includes a person who was at the relevant time ordinarily resident in Canada. The interrelationship of resident and ordinarily resident was first dealt with in the Canadian context by the Supreme Court of Canada in the classic case of *Thomson v. M.N.R.*⁸¹ Rand, J. noted that '[f]or the purposes of income tax legislation, it must be assumed that every person has at all times a residence. It is not necessary to this that he should have a home or a particular place of abode or even a shelter. He may sleep in the open. It is important only to ascertain the spatial bounds within which he spends his life or to which his ordered or customary living is related'. As for the meaning of 'ordinarily resident', after reviewing U.K. authority, Rand, J. said that:

The expression 'ordinarily resident' carries a restricted signification, and although the first impression seems to be that of a preponderance in time, the decisions on the English Act reject that view. It is held to mean residence in the course of the customary mode of life of the person concerned [i.e. not temporary in time and exceptional in circumstances], and it is contrasted with special or occasional or casual residence. The general mode of life is, therefore, relevant to a question of its

⁸⁰ See *supra* note 31 at 684.

⁸¹ *Thomson v. M.N.R.* [1945] C.T.C. 63 at 73 (Exch. Ct.) See also: Morris D. B., "Jurisdiction To Tax: An Up-Date" (1979) Report of Proceedings of the Thirty-first Tax Conference 414 at 416.

application.

... Ordinary residence can best be appreciated by considering its antithesis, occasional or casual or deviatory residence. The latter would seem clearly to be not only temporary in time and exceptional in circumstances, but also accompanied by a sense of transitoriness and of return.⁸²

Rand, J. also suggested that if the word 'resident' was given its fullest connotation, it should encompass any sort of residence, be it casual, permanent, or ordinary.

... [In] the different situation of so-called 'permanent residence', 'temporary residence', or 'ordinary residence' and the like, the adjectives do not affect the fact that there is in all cases residence; and that quality is chiefly a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question. It may be limited in time from the outset, or it may be indefinite, or so far as it is thought of, unlimited. On the lower level, the expression involving residence should be distinguished, as I think they are in ordinary speech, from the field of 'stay' or 'visit'.

Some commentators have noted that '[t]he courts have failed to clarify the relationship between the meaning of 'resident' in subsection 2 (1) of the *Act* and 'ordinarily resident' in subsection 250 (3)'.⁸³ As for the meaning of 'ordinarily resident', differing from the decision of the majority in *Thomson v. M.N.R.*, Brian G. Hansen in 'Individual Residence', 1977 Conference Report has said:

'Ordinarily resident' should be narrower than 'resident'. Any situation where an adverb qualifies an adjective must lead to this result. This is clearly the attitude of Rand J. in *Thomson v. M.N.R.*, where he stated that 'ordinarily resident' has a

⁸² Residence can be broader than just a house, for example, in this case 'ordinary residence' was a strip of land running from Florida to New Brunswick. The term applied to a presence in Canada which is outside the range of temporary residence. In this case, it can also be concluded that citizenship is irrelevant to residence, and the taxpayer may be resident of more than one country for tax purposes. See also: Hansen B.G., "Individual Residence" in Canadian Tax Foundation, *Report of Proceedings of the Twenty-ninth Tax Conference*, (Toronto: Canadian Tax Foundation, 1977).

⁸³ See *supra* note 39 at 174.

'restricted significance'. In fact, if 'resident' was given its fullest connotation it should encompass any sort of residence be it 'casual', 'transitory', 'permanent', or 'ordinary'. In other words, technically the two phrases mean the same thing. However, from a practical point of view, in my view, 'ordinarily resident' has a wider scope than 'resident'. Where a court considers whether a taxpayer is 'resident' in Canada, there is a natural tendency to focus on the taxation year in question. I believe it is this factor which has occasionally led courts to suggest that physical presence is essential to a finding of residence in any one taxation year. On the other hand, 'ordinarily resident' permits the court to review a taxpayer's activities over a period of years'.⁸⁴

Since Hansen's article was published in 1977, the number of cases in which taxpayers have been found to be 'ordinarily resident' in Canada has increased.⁸⁵ It is clear from court decisions that 'ordinarily resident' widens the scope of 'resident'.⁸⁶ For example, as pointed out by Mahoney J., in *The Queen v. K. F. Reeder*,⁸⁷ Mr. Reeder, the defendant, a Canadian citizen taking training in France before being employed in Canada still remained an ordinary resident in Canada during the time he was in France, because the defendant's ties were always with Canada and the actual duration of his absence from Canada, nine months, was temporary. In the *Reeder* case, the Federal Court Trial Division set out certain factors to be considered in determining whether a taxpayer was 'ordinarily resident' in Canada. These factors include: past and present habits of life, regularity and length of visits in the jurisdiction asserting residence, ties within the jurisdiction and

⁸⁴ See *supra* note 31 at 693.

⁸⁵ See *supra* note 39 at 174. These cases are, for example: *The Queen v. Sherwood*, [1978] C.T.C. 713, 78 D.T.C. 6470 (F.C.T.D.); *Rajotte v. M.N.R.*, [1979] C.T.C. 2555, 79 D.T.C. 436 (T.R.B.); *Saunders v. M.N.R.*, [1980] C.T.C. 2436, 80 D.T.C. 1392 (T.R.B.); and *Roy v. M.N.R.*, [1983] C.T.C. 2644, 83 D.T.C. 576 (T.R.B.)

⁸⁶ See *supra* note 39 at 174.

⁸⁷ *The Queen v. K. F. Reeder* [1975] C.T.C. 256, 75 D.T.C. 5160 (F.C.T.D.).

elsewhere, permanence of purposes of stay abroad, etc.. In this case, since the defendant's ties were always with Canada, the defendant was ordinarily resident in Canada. In other words, the court looked at a longer period of time than one taxation year when considering the concept of 'ordinarily resident'. In addition, it is clear that the mere passage of time is no longer of the essence in determining whether a person remained resident or ordinarily resident in Canada during his/her physical absence. The temporary nature of a taxpayer's absence and the existence of continuing ties within Canada will preserve the status of residency.⁸⁸ The principle was accepted unreasonably in some cases involving professors on sabbatical leave outside Canada. The taxpayers were held to be resident in Canada notwithstanding a physical absence of about 12 months.⁸⁹ Showing no favoritism, the Tax Review Board held that two individuals studying outside Canada were ordinarily resident in Canada.⁹⁰ In one instance, this determination was made notwithstanding an uninterrupted absence of approximately two and one-half years during which time the only nexus with Canada was a bank account into which federal and provincial government grants were deposited.⁹¹

(2) Part-time Residence

⁸⁸ See: Morris D. B., "Jurisdiction To Tax: An Up-Date" (1979) Report of Proceedings of the Thirty-first Tax Conference 414 at 417.

⁸⁹ *Hoyt v. M.N.R.*, [1977] C.T.C. 2401 (T.R.B.), and *Park v. M.N.R.*, [1979] C.T.C. 2817 (T.R.B.). See also *supra* note 88 at 417 - 418.

⁹⁰ *Bouchard v. M.N.R.*, [1978] C.T.C. 2071 (T.R.B.), and *Grevais v. M.N.R.*, [1979] C.T.C. 2003 (T.R.B.). See also *supra* note 88 at 417 - 418.

⁹¹ *Grevais v. M.N.R.*, [1979] C.T.C. 2003 (T.R.B.). See also *supra* note 88 at 418.

Part-time residence is defined in section 114 of the *Act* as:

[individual resident in Canada during only part of the year]: Notwithstanding subsection 2(2), where an individual is resident in Canada throughout part of a taxation year, and throughout another part of the year is a non-resident, the individual's taxable income for the year is the amount by which the total of (a) the individual's income for the period or periods of the year when the person was resident in Canada, and (b) the amount that would be the individual's taxable income earned in Canada for the year if at no time in the year the individual had been resident in Canada; exceed (c) [the total of permitted deductions].

In the *Act*, subsection 2(1) applies to every person who was resident in Canada 'at any time in the taxation year'. Subsection 2(3) then deals with all persons who were not resident in Canada at any time in the year, and provides that their taxable income shall be determined in accordance with Division D (i.e. sections 115 and 116). A middle ground is recognized in section 114, which deals with the situation of an individual who either takes up or gives up residence in Canada during the course of a taxation year (i.e. calendar year). The effect of this rule is that the individual's worldwide income only for the period in which he/she resides in Canada is brought into charge, and the individual is taxed as a non-resident on Canadian-source income for the period of non-residence.⁹²

*Schujahn v. M.N.R.*⁹³ held that in order to show that someone was a part-time resident one must demonstrate that the individual has 'commenced' or 'ceased' to reside in Canada some time in the business year. The same principle has emerged in other cases, for example, as pointed out by Taschereau J., in the *Thomson* case [1946] C.T.C. 51 at p. 58:

Moreover in the majority of these cases, the taxpayer was held liable not because his

⁹² See: Stikeman H.H. et al., *Canada Tax Service*, vol. 8 (Ontario: Carswell, 1997) at 114-103, 114-104.

⁹³ *Schujahn v. M.N.R.* [1962] C.T.C. 364, 62 D.T.C. 1225 (Exch.Ct.).

visits to England were of such a nature that they were considered sufficient to qualify him as a 'resident', but for the reason that he had never **ceased** to be a resident of England, and that his occasional absence had never deprived him of the status of British resident.⁹⁴

The application of section 114, regarding the taxable income of a part-time resident, is distinguished from those of subsection 2(1) and section 115, depending on the respective situations. Special Release to Interpretation Bulletin IT-193 SR⁹⁵ states that section 114 applies to determine the taxable income of an individual who was resident in Canada during part of the year only and who, during the other part of the year was not resident, not employed and not carrying on business in Canada or, if the individual was employed or carrying on business in Canada, it was for a portion only and not for the whole of that part of the year while a non-resident. The distinction between section 114 and subsection 2(1) is that section 114 does not apply where an individual was resident in Canada part of the year, non-resident the other part of the year, and during the entire period of non-residence was either employed in Canada or carried on business in Canada. In this case, the provisions of subsection 2(1) will tax the individual on worldwide income for the entire year. In addition, the distinction between section 114 and section 115 is that section 114 does not apply where an individual was employed in Canada or carried on business in Canada but was not resident in Canada at any time in the year or to an individual who sojourned in Canada for less than 183 days. In these circumstances, section 115 applies.

⁹⁴ *Thomson v. M.N.R.* [1946] C.T.C. 51, 2 D.T.C. 812 (S.C.C.)

⁹⁵ See: paragraph 4 of the Interpretation Bulletin IT-193 SR, September 30, 1985, regarding 'Taxable Income of Individuals Resident in Canada during Part of a Year'.

(3) Non-resident

The tax liability of a non-resident in Canada is provided in subsection 2(3) and Part XIII of the *Act*. Subsection 2(3) states:

[Tax payable by non-resident persons] -- where a person who is not taxable under subsection (1) for a taxation year

- (a) was employed in Canada,
- (b) carried on a business in Canada, or
- (c) disposed of a taxable Canadian property,

at any time in the year or a previous year, an income tax shall be paid, as required by this Act, on the person's taxable income earned in Canada for the year determined in accordance with Division D.

Subsection 2(3) of the *Act* contains the second of the two general charging provisions under Part I of the *Act*. The first, in subsection 2(1), applies to all persons who were residents in Canada at any time in the year. Subsection 2(3) applies to persons who are not taxable under subsection 2(1), i.e. to persons who were not resident in Canada at any time in the year. To bear the charge of tax, however, such a person must also have been employed in Canada, or, have been carrying on business in Canada, or have disposed of a 'taxable Canadian property' at any time in the taxation year or 'a previous taxation year'⁹⁶. Notwithstanding the reference to 'a previous year' in the above charging provision, the

⁹⁶ The reference in subsection 2(3) to 'a previous year' brings under the taxing provisions of Part I an amount of income listed in section 115 which might otherwise escape taxation if it were received or realized in a year subsequent to the year in which it had been earned. For example, a non-resident individual ceased to be employed in Canada in late 1989 but received remuneration from that employment in 1990. The amount is taxable in 1990 under section 115. See: Interpretation Bulletin IT-420R3, paragraph 4.

non-resident's taxable income in Canada as determined under Division D is restricted to his/her income for the year imputable to the prescribed Canadian sources.⁹⁷

Income from an office or employment in Canada is required by subsection 2(3) and subparagraph 115(1)(a)(i) to be included in a non-resident's calculation of income earned in Canada. In computing the income, regard must first be had to the definitions of 'office' and 'employment' contained in subsection 248(1) and to the provisions of sections 5 to 8 regarding amounts which must be included and deductions which may be claimed in the computation of such income.⁹⁸ A non-resident individual caught by these charging provisions must then turn to sections 115 and 116 (i.e. Division D) for the rules by which his/her taxable income is determined. However, if the non-resident's employment duties are performed both inside and outside Canada, a reasonable basis for allocating the related income is necessary since only the Canadian-source income is taxable under section 115 in part I of the *Act*. In addition, if an individual meets the situations⁹⁹ prescribed in

⁹⁷ Stikeman H.H. et al., *Canada Tax Service*, vol. 1 (Ontario: Carswell, 1997) at 2-301. For the computation of non-resident's taxable income earned in Canada, see: Interpretation IT-420R3. See also: Interpretation IT-171R2.

⁹⁸ According to paragraphs 6 and 7 of the Interpretation Bulletin IT 420-R3, for income earned by non-residents from an office or employment, it refers to the extent that the duties involved are performed in Canada. The rules of sections 5 to 8 of the *Act* are generally applicable. Accordingly, income from an office or employment in Canada includes employment benefits (e.g.: stock option benefits and deferred amounts under salary deferral arrangements), living and personal allowance, and director's fees, to the extent that these amounts are attributable to services rendered in Canada. The employment income earned in Canada which is reported under subparagraph 115(1)(a)(i) can be reduced by the deduction of expenses described under section 8 of the *Act*, such as traveling expenses under paragraphs 8(1)(f), (g) or (h), to the extent that they are reasonably considered applicable to such income. See also *supra* note 92 at 115-111.

⁹⁹ The situations provided in subparagraph 115(2) are: (i) a student in full-time attendance at a university, college or educational institution providing post-secondary school level courses in Canada (subparagraph 115(2)(a)), (ii) a former resident who left to attend or teach at a university or post-secondary school outside Canada (subparagraph 115(2)(b)), (iii) a former resident who left to accept a grant to carry on research etc. (subparagraph 115(2)(b.1)), (iv) an individual formerly employed in Canada but now abroad on leave of absence and still in receipt of remuneration from his/her regular employment (subparagraph

subsection 115(2), he/she is deemed, by virtue of subparagraph 115(2)(d) to have been employed in Canada in the year. The individual's income from such deemed employment is to be determined in accordance with subparagraph 115(2)(e).

Income earned in Canada by a non-resident includes, by virtue of subparagraph 115(1)(a)(ii), income from carrying on business in Canada.¹⁰⁰ However, if a non-resident carries on a business both in Canada and outside Canada, a reasonable allocation of the related income is necessary since only the portion earned in Canada must be reported under subparagraph 115(1)(a)(ii) in part I of the *Act*. Generally, the Canadian-source income will be the portion attributable to the business operations carried on in Canada.

To determine whether an individual 'carried on business in Canada', the tests used by the court are generally confined to an examination of (1) the place where contract is made¹⁰¹ (2) the site at which operations producing profit take place¹⁰² (3) the place where payment, or delivery, takes place¹⁰³ or (4) the place of the presence of representative or

115(2)(c)), or (v) a person who received a 'signing bonus' or similar amount in respect of services to be performed in Canada (subparagraph 115(2)(c.1)) (applicable with respect to amount received after November 12, 1981).

¹⁰⁰ In addition, section 253 indicates some situations where a non-resident will be deemed to be 'carrying on business' in Canada. Generally, the rules applying to residents for the computation of income from a business apply equally to non-residents. Any exceptions are clearly expressed in the *Act* or in the Canadian Income Tax Regulations. For details regarding income earned by non-resident from a business, see: paragraphs 8 - 15 of the Interpretation Bulletin IT 420-R3.

¹⁰¹ See: Stikeman H.H. et al., *Canada Tax Service*, vol. 1 (Ontario: Carswell, 1997) at 2-303.

¹⁰² *Ibid.* at 2-304 to 2-309.

¹⁰³ *Ibid.* at 2-309.

resident expert.¹⁰⁴ Of all the factors which may be present which may constitute a carrying on of business within a jurisdiction, the most important is, from the case law, 'where the contract is made', which is the basis of the transaction, or, stated more broadly, where the action or thing is done from which the profits in the transaction flow.¹⁰⁵ For example, in *Grainger & Son v. Gough (Surveyor of Taxes)*,¹⁰⁶ the appellants were wine merchants in London, acting as agents for a French wine merchant, M. Louis Roederer. All that the appellants had done in the U.K. on behalf of the French wine merchant had been to canvass for orders, to transmit to him those orders, when obtained, and in some cases to receive payment on his behalf. It was held that the principal test in determining whether business is carried on in one jurisdiction is where the contract was made. Since no contracts to sell wine were made by the appellants, the French wine merchant was not carrying on business in the U.K. and therefore the French wine merchant was not liable to income tax. However, after this case was decided, other factors became equally important. For example, in *Smidth & Co v. Greenwood*,¹⁰⁷ Atkin, LJ emphasized the importance of looking beyond the mere signing of the contract and taking into consideration of where the operations take place from which the profits in substance arise. Later, in *G.L.S. Leasco Inc., McKinlay Transport v. M.N.R.*,¹⁰⁸ the factor of 'the place where payment or delivery takes place' was taken into account. The court held that the

¹⁰⁴ *Ibid.* at 2-309 to 2-310.

¹⁰⁵ See *supra* note 101 at 2-303 to 2-310.

¹⁰⁶ *Grainger & Son v. Gough (Surveyor of Taxes)* [1986] A.C. 325 (H.L.)

¹⁰⁷ *Smidth & Co v. Greenwood*, [1921] 3 K.B. 583; [1922] A.C. 417; 8 T.C. 193.

¹⁰⁸ *G.L.S. Leasco Inc., McKinlay Transport v. M.N.R.* [1986] 2 C.T.C. 2034 (T.C.C.).

company intended to carry on business in Canada, not only from the facts that the company established a bank account in Canada, purchased products in Canada, had an official agent in Canada and the dealing was not at arm's length, and the contracts were executed in Canada, but also all purchase orders were made in Canada, paid for in Canadian dollars, and delivery of the equipment was taken in Canada for use in Canada (where the company earned a profit). It was held that the question of whether or not a company is 'carrying on business' is a matter of fact and that it is a compound fact made up of a variety of incidents. In addition, the theory of substance over form¹⁰⁹ was applied in this case. Thus, it was held that in substance the company was carrying on business in Canada. The factor 'presence of representative or resident expert' is important in cases where the very object of the transaction is the rendering of service by a non-resident in Canada, and a non-resident technician enters Canada to carry out the terms of the undertaking and to perform the service which was the principal object of the contract.

¹⁰⁹ Substance over form is a doctrine used in some jurisdictions, for example, the U.S. and Taiwan, to curb tax evasion. The doctrine emphasizes that 'the assessment of taxpayer's transactions with an eye to commercial and economic realities, rather than juristic classification of form, may help to avoid the inequity of tax liability being dependent upon the taxpayer's sophistication at manipulating a sequence of events to achieve a patina of compliance with the apparent prerequisites for a tax deduction'. See: *The Queen v. P.B. Bronfman Trust*, [1987] 1 C.T.C. 117, 87 D.T.C. 5059 (S.C.C.) at 128.

The U.S. courts look to the substance of a transaction and ignore its form in determining the taxpayer's tax liability. Actually, the central concern of American courts is to determine the substance of a transaction. See: Arnold B.J. & Wilson J.R., "The General Anti-Avoidance Rule -- Part I" (1988) 36 Canadian Tax Journal 829 at 881.

Substance over form has been the doctrine that the tax authority in Taiwan utilizes to counter abuses of tax-haven base companies and schemes of tax avoidance after the Exchange Control doctrine was abolished in 1987. The substance over form doctrine deems these tax haven entities to be domestic companies, if the companies meet certain residence standards. The tests used to determine the residence of a company vary from country to country but, in general, there are five types of tests: (i) the place of incorporation (*lex incorporationis*), (ii) the place of central management (*lex domicilii*), (iii) the principal place of business, (iv) the place of the residence or nationality of management, (v) the place of residence or the nationality of the controlling shareholders. A country may use one or more of the tests. In Taiwan, generally, *lex incorporationis* is applied, but in certain cases *lex domicilii* may also be applied. See: Yang C., "Taiwan's Control of the Tax Sheltering Use of Tax Haven Base Companies: Substance over Form Rule or Subpart F-Type Legislation?" (1993) 31:231 Columbia Journal of Transnational Law 231 at 245, 247.

Entry of the technician into Canada in such cases will be sufficient to constitute a carrying on of business on the part of the non-resident principal. If, therefore, the contract is for the rendering of service within Canada, and such service is not ancillary to a superior consideration to be performed outside of Canada, then the entry into Canada of the non-resident or his agent to perform the service will render such non-resident liable to tax as carrying on business in Canada.¹¹⁰ Decided Canadian cases of any value on this point are few. The most important case appears to be the decision of the Privy Council in *International Harvester Co. of Canada v. Provincial Tax Commission*.¹¹¹ The appellant corporation was resident outside Saskatchewan and its business within the province was limited to the making of sale contracts by its agents who remitted the profits. The company was assessed by virtue of a regulation which held the company's income within the province to be that percentage of its income that its sales within the province bore to its total sales.¹¹²

Section 253 of the *Act* reinforces and extends the common law concept of carrying on business in Canada. An extended meaning of 'business' is found in the definition of that term in subsection 248(1). A 'business' is defined as including a 'profession, calling, trade, manufacture or undertaking of any kind whatever', including (except for certain specified purposes) 'an adventure or concern in the nature of trade'. Whether a

¹¹⁰ See *supra* note 101 at 2-309 to 2-310.

¹¹¹ *International Harvester Co. of Canada v. Provincial Tax Commission*, [1948] C.T.C. 307.

¹¹² See *supra* note 101 at 2-310.

transaction is 'an adventure ... in the nature of trade' engaged in in Canada by a non-resident was assimilable to 'carrying on business' in Canada within subsection 2(3) was at issue in *Tara Exploration and Development Co. Ltd. v. M.N.R.*¹¹³ The court held that the appellant company did not carry on business in Canada because under subsection 2(2) then (subsection 2(3)), the profits made from 'an adventure in the nature of trade' by a non-resident person did not constitute carrying on a business in Canada under subsection 139(1)(e) then (subsection 248(1)). However, under the current subsection 253 (c) of the *Act*, such a company would now be regarded as carrying on business in Canada and would be liable to Canadian income tax.

In addition to income earned in Canada from employment or business carried on in Canada, a non-resident person must compute income earned in Canada, under subparagraph 115(1)(a)(iii) and paragraph 115(1)(b).¹¹⁴ Therefore, taxable capital gains from dispositions in that year of capital property that is 'taxable Canadian property'¹¹⁵ less

¹¹³ *Tara Exploration and Development Co. Ltd. v. M.N.R.*, [1970] C.T.C. 557 (Exch.). See also *supra* note 101 at 2-311.

¹¹⁴ Paragraph 115(1)(b) of the *Act* describes in detail the properties included in the term 'taxable Canadian property'. Dispositions of taxable Canadian property include deemed dispositions. Similarly, proceeds of disposition include deemed proceeds, such as the fair market value of a property disposed of in a non-arm's length transaction where the proceeds would otherwise be a greater amount. See: paragraphs 16 and 17 of the Interpretation Bulletin IT-420 R3. The purpose of paragraph 115(1)(b), that is what is meant by 'interests in and options on real property and shares', is considered in Interpretation Bulletin IT-176 R2.

¹¹⁵ 'Taxable Canadian property' is currently defined in paragraph 115(1)(b) of the *Act* to include the following:

- (i) real property situated in Canada or any interest therein,
- (ii) capital property used by the non-resident in carrying on a business in Canada,
- (ii.1) capital property used by a non-resident insurer in the year or held in the year in the course of carrying on an insurance business in Canada,
- (iii) a share of the capital stock of a corporation resident in Canada (other than a public corporation) or some interest therein,

allowable capital losses from such disposition are included in income. Section 38 defines a taxpayer's taxable capital gain as 3/4 of the taxpayer's capital gain, and a taxpayer's allowable capital loss as the same portion of the taxpayer's capital loss. Such gains or losses are computed in the normal manner under the provisions of subdivision c, although some of these provisions, such as those regarding listed personal property, are by their very nature inapplicable. Non-residents who dispose of 'taxable Canadian property' other than depreciable property or 'excluded property'¹¹⁶ are subject to the special reporting requirements set out in section 116.¹¹⁷ In addition, Part XIII of the *Act* taxes non-residence on certain payments received from Canadian sources.

2.3 Personal Link System and Territorial System

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- (iv) a share of the capital stock of a public corporation if at any time during such part of the period of 5 years immediately preceding the disposition thereof as is after 1971, not less than 25 per cent of the issued shares of any class of the capital stock of the corporation belonged to the non-resident person and/or to persons with whom the non-resident was not dealing at arm's length,
 - (v) an interest in a partnership, if at any time during the 12-month period immediately preceding its disposition the total fair market value of the partnership's Canadian resource property, timber resource property, its income interests in trusts resident in Canada, and of any other property described in paragraph 115(1)(b), was at least equal to 50 per cent of the total fair market value of all the partnership property (including cash) at that time.
 - (vi) a capital interest in a trust (other than a unit trust) which is resident in Canada,
 - (vii) a unit of a unit trust (other than a mutual fund trust) which is resident in Canada,
 - (viii) any unit of a mutual fund trust if at any time during such part of the period of five years immediately preceding the disposition thereof as is after 1971, the non-resident person and /or persons with whom the non-resident did not deal at arm's length owned not less than 25 per cent of the issued units of the trust,
 - (ix) any other property deemed by any provision of the Canadian Income Tax Act to be taxable Canadian property.

See: paragraph 115(1)(b) of the *Act*. See also *supra* note 92 at 115-119 to 115-122A.

¹¹⁶ For the definition of 'excluded property', see: subsection 116(6) of the *Act*.

¹¹⁷ See *supra* note 92 at 115-117, 115-118.

A country cannot levy tax on a person who has no connection to the country. Different countries use different connecting factors¹¹⁸ when imposing taxes on individuals. There are two systems underlying the various connecting factors, namely, the 'Personal Link System' and the 'Territorial System'.¹¹⁹ The Personal Link System, with different criteria in determining the personal link, contains both the 'citizenship' (or 'nationality') and the 'residence' connecting factors. 'Citizenship' is used in the United States (U.S.) to identify the people liable to pay income tax in the U.S.. In this context, whoever holds citizenship of the country shall be subject to tax, regardless of whether he/she is a resident in the country. Residence is the principal connecting factor which is used for Canadian income tax.¹²⁰ The residence connecting factor subjects the individuals to tax by determining whether he/she is a resident of that country, in accordance with the country's income tax law. On the contrary, the Territorial System utilizes the principle that anyone who stays in the territory, regardless of whether he/she holds citizenship of the country or is resident in it, shall be subject to tax.¹²¹ The Territorial System is adopted in Taiwan for tax purposes.

2.3.1 Comparison of Personal Link System and Territorial System

¹¹⁸ There are four connecting factors that are used in different countries to make connections to subject the individuals to tax, namely, (1) source (2) citizenship (3) domicile (4) residence. See *supra* note 22 at 109 - 111. See also *supra* note 31 at 153. These scholars regard the most common bases for imposing income taxation as citizenship or nationality, residence, and the source of income.

¹¹⁹ See *supra* note 2 at 39. See also *supra* note 7 at 20, 29.

¹²⁰ See *supra* note 34 at 111.

¹²¹ See *supra* note 2 at 39.

The theory underlying the Personal Link System is that a country has power over its people and the power comes from the conferment on these people of rights.¹²² In contrast, the Territorial System is based on the concept that a country can execute its authority within its territory.¹²³ In the Personal Link System, in order to tax the individuals by personal factors (either citizenship or residence), more complicated auditing techniques are demanded.¹²⁴ It requires the tax authority to get access to every taxpayer's personal information related to his/her worldwide income (including domestic source income and income from overseas) for tax purposes, in order to prevent revenue loss.¹²⁵ In contrast, the Territorial System only taxes the individuals on income that is earned in the territory and not on the taxpayer's worldwide income. Thus, tax avoidance is more effectively curbed because of the tax authority's easy access to any information in that territory.¹²⁶

¹²² *Ibid.*

¹²³ *Ibid.*

¹²⁴ The tax authority has to have the ability to get access to the information regarding the foreign-source income of the taxpayers, otherwise, not only will the country suffer revenue loss, but the equity principle will be violated. Since equals shall be treated equally, if those who have the same ability to pay do not pay the same amount of tax as the honest taxpayers, the horizontal equity principle will be violated. Even though taxing foreign-source income can increase the revenue, it also requires more expense with respect to auditing and tax collection and increases the tax authority's work load. See *supra* note 2 at 68. See also: Chow W., "More Canadians hiding assets overseas to avoid tax: Auditor -- Canada's offshore assets reporting law is justified, A-G says in report", The Vancouver Sun, June 6, 1998. A1, A2.

¹²⁵ As the federal auditor-general of Canada, Denis Desautels, said (quoted in the report abstracted in the Vancouver Sun): 'Canadians, increasingly, are investing offshore and there are signs that some are not reporting their foreign income to Revenue Canada. Therefore, they are not paying tax on this income'. 'This violates the basic principle that residents in Canada are taxed on their worldwide income. It is also unfair to taxpayers who are reporting 100 percent of their income and who must shoulder a greater portion of the tax burden'. See: Chow W., "More Canadians hiding assets overseas to avoid tax: Auditor - Canada's offshore assets reporting law is justified, A-G says in report", The Vancouver Sun, June 6, 1998. A1, A2.

¹²⁶ See *supra* note 2 at 39.

2.3.2 A Blend of Personal Link System and Territorial System

The exclusive adoption of the Personal Link System is rare. In the U.S., a combination of the two systems (the Personal Link System and the Territorial System) is utilized.¹²⁷ In the U.S., citizenship is the principal connecting factor for tax purposes and residence is another.¹²⁸ Specifically, both U.S. citizens and any individuals who are permanent residents in the U.S. will be taxed on their worldwide income.¹²⁹ The rationale for citizenship may be expressed in terms of the traditional obligation of every citizen or national to help support the state through taxation, whether the citizen is living within or without the state's borders. This view rests on the 'cost and benefits' view of taxation in the sense that each citizen enjoys the protection and service provided by his/her country and ought to pay the cost of the government's services in accordance with the particular benefits conferred on the individual.¹³⁰ However, as some scholars suggest: '... given today's mobility, taxation based on citizenship or nationality attributes an exaggeration of the importance to the jurisdiction in which an individual (or corporation) was born or obtained nationality'.¹³¹ 'More importantly, citizenship or nationality tends to unduly

¹²⁷ See *supra* note 7 at 20, 29.

¹²⁸ Ault H.J., *Comparative Income Taxation: A Structural Analysis* (Den Haag, the Netherlands: Kluwer Law International, 1997) at 137.

¹²⁹ See *supra* note 7 at 29 - 30.

¹³⁰ See: Sherbaniuk D.J., "Liability for Tax -- Residence, Domicile or Citizenship?" in *1963 Conference Report* (Toronto: Canadian Tax Foundation, 1964) at 315. See also *supra* note 39 at 153 -154.

¹³¹ See *supra* note 39 at 154.

emphasize the political connection between a person and a country. Also relevant for tax purposes is the degree of economic connection between a person and a given country'.¹³² Taking citizenship as an exclusive connecting factor while not taking into account other economic connections will expose that factor's weaknesses and/or disadvantages. The argument, no doubt, is that under the system even the non-citizen resident is entitled to the protection of his or her person and property by the government of his or her residence but is not subject to tax.¹³³ On the other hand, the disadvantage of citizenship is that 'it would sweep in many people whose links with the taxing country had become (for non-tax reasons) very tenuous, and it would exclude many people living permanently in the taxing country'.¹³⁴ This makes the principle of taking citizenship as the exclusive connecting factor disputable and vulnerable. The advantage of accepting citizenship as the connecting factor is that 'citizenship enables the taxing country to tax those of its citizens who have moved to tax havens such as the Bahamas or Bermuda (although such people could change their citizenship, and even if they did not enforcement would be difficult)'.¹³⁵ Due to both the advantages and disadvantages, the U.S. therefore 'has to modify the principle of citizenship by also taxing resident aliens and by providing partial exemption for the foreign income of non-resident citizens'.¹³⁶

¹³² *Ibid.*

¹³³ See *supra* note 34 at 110.

¹³⁴ *Ibid.*

¹³⁵ See *supra* note 34 at 110. For detailed reasons why the U.S. use citizenship as the connecting factor to subject individuals to tax, see: paragraph 6.2.1 'Comparison of the OECD Model and the U.S. Model' in chapter 4.

¹³⁶ *Ibid.* See also: Bale in Hansen, Krishna, Rendall (eds.), *Canadian Taxation* (1981) at 23.

2.3.3 Personal Link System in Canada

As mentioned above, residence is the principal connecting factor used for Canadian income tax purposes. Since residence is one of the criteria utilized in determining the individual's tax liability, and citizenship is the other, it can be concluded that the personal link system is used in Canada for Canadian income tax purposes. It is noted that the reasons for the selection, by the Canadian Parliament, of residence as a basis for taxation are elusive.¹³⁷ However, Canadian Parliamentarians passed the first federal income tax law, the Income War Tax Act of 1917, in which tax jurisdiction was based on the concept of 'residence' which has persisted as the basis of Canadian income tax jurisdiction.¹³⁸ Residents of Canada are taxed on their worldwide income, and non-residents on their income derived from sources in Canada. 'It is probably close to the mark to say that, in this instance, Parliament chose to follow British precedent and adopt the same general scheme for the exercise of income tax jurisdiction as was found in the United Kingdom income tax law'.¹³⁹ Historically, for Canadian income tax, Canada borrowed its original tax statute law substantially from the United States and its jurisprudence from England.¹⁴⁰ Although the Canadian legislation differed substantially from the British legislation, it is

¹³⁷ See: Sherbaniuk D.J., "Liability for Tax -- Residence, Domicile or Citizenship?" in *1963 Conference Report* (Toronto: Canadian Tax Foundation, 1964) at 316.

¹³⁸ *Ibid.*

¹³⁹ *Ibid.*

¹⁴⁰ Perry J.H., *Taxation in Canada*, (Toronto: Canadian Tax Foundation, 1990) at 37.

likely that in this regard Canada decided to follow the British model. 'In 1799 when Pitt introduced the first income tax to Britain, it was residence that was adopted as the principal basis for taxation and this has continued to be the case in Britain'.¹⁴¹

Commentary by Henry E. Hutcheon states that 'citizenship, even if it were a satisfactory basis of liability for tax, which I very much doubt, was not within the realm of the possible, of course, since this was 1917, thirteen years before the Statute of Westminster and nineteen years before such a thing as Canadian citizenship as a status existed'.¹⁴²

There was thus doubt in 1917, even if the status of Canadian citizenship were created, that Canada would have had the power to tax Canadian citizens residing abroad. Such a basis could have been construed as having extraterritorial effect.¹⁴³ A leading authority on Canadian constitutional law stated:

Limitations on legislative power in Canada immediately following the enactment of the British North America Act, apart from those inhering in the distribution of legislative power effected by the Act, were as follows: ... (3) The Parliament of Canada was, apparently, precluded from legislating with extraterritorial effect, although this was not explicit in the British North America Act in its case as it was, by and large, in respect of the provincial legislatures.¹⁴⁴

After the Imperial Parliament passed the Statute of Westminster in 1931 any doubt about whether the Parliament of Canada could tax Canadian citizens on their worldwide income

¹⁴¹ Hansen B.G., Krishna V. & Rendall J.A., eds., *Essays on Canadian Taxation* (Toronto: Richard De Boo Limited, 1978) at 24.

¹⁴² Hutcheon H.E., "Liability for Tax-- Residence, Domicile or Citizenship?" (1964) 1963 Report of the Canadian Tax Foundation Conference, 325 at 326.

¹⁴³ See *supra* note 141 at 24.

¹⁴⁴ Laskin B., *Canadian Constitutional Law: Cases, Text and Notes on Distribution of Legislative Power*, 2nd ed. (Toronto: Carswell, 1960) at 61.

was removed. Section 3 of the Statute expressly empowered the Parliament of Canada to legislate with extra-territorial effect.¹⁴⁵

It is thus clear that Canada, at least since 1931, after the Statute of Westminster was passed, has been free to adopt citizenship as an auxiliary basis upon which to tax worldwide income. The Carter Report, which subjected the Canadian tax system to a very scholarly analysis and indicated many deficiencies in it, did not recommend a different basis.¹⁴⁶ The report stated:

We recommend that residence continue to be the principal basis for determining liability to tax, largely because residence seems to imply a closer association than citizenship between the taxpayers and the use of services provided by a taxing jurisdiction. It is the test which has been followed from the beginning of Canadian income tax and on which most of our existing practice is based.¹⁴⁷

One difficulty with taxing the resident alien on his/her worldwide income is being criticized as 'tax without vote'. The violation of the principle that 'there should be no taxation without representation' caused a major upheaval in the southern half of this continent in the latter part of the eighteenth century. However, since the United States taxes resident aliens on their worldwide income, it should probably not disturb Canada that it also taxes resident aliens on their worldwide income and, also like the United States, denies them the right to vote in national elections.¹⁴⁸

¹⁴⁵ See *supra* note 141 at 24.

¹⁴⁶ *Ibid.*

¹⁴⁷ Royal Commission on Taxation (Carter Report) (1967), vol. 4, p. 541.

¹⁴⁸ See *supra* note 141 at 24 - 25.

2.3.4 Territorial System in Taiwan

The Personal Link System is adopted by most of the countries in the world,¹⁴⁹ although in Taiwan, the Territorial System is utilized for its income tax purposes.¹⁵⁰ Article 2 of the income tax law of Taiwan says: '[f]or any individual having income from *sources* in the Republic of China (Taiwan), consolidated income tax shall be levied in accordance with this law on his/her income derived from *sources* in the Republic of China. Unless otherwise provided in this law, in the case of an individual who is a non-resident in the Republic of China but who has income derived from *sources* in the Republic of China, income tax payable by him/her on all such income shall be withheld and paid at the respective *sources*.'¹⁵¹ Due to Taiwan's adoption of the Territorial System, any individual who earns domestic source income from Taiwan shall pay tax in Taiwan, regardless of his/her citizenship or whether he/she is resident in Taiwan,¹⁵² whereas, the foreign-source income is not subject to income tax in Taiwan. For example, overseas interest or dividend income, regardless of whether it is transferred into Taiwan, is not subject to Taiwan tax.¹⁵³ This is distinct from the Personal Link System, in which anyone who is regarded as a citizen or resident of that country will be taxed on his/her worldwide income.

¹⁴⁹ See *supra* note 2 at 69.

¹⁵⁰ *Ibid.*

¹⁵¹ See: article 2 of the Income Tax Law of Taiwan, MOEA (1995) at 1.

¹⁵² See *supra* note 2 at 69.

¹⁵³ *Ibid.*

It is mainly due to Taiwan's special political situation that Taiwan adopts the Territorial System, and so does not impose tax on the taxpayer's worldwide income. Taiwan has its political problem of not always being recognized as a legal jurisdiction. Taiwan has signed treaties with only about twenty, mostly small, countries.¹⁵⁴ Even though a tax treaty is the most efficient mechanism to avoid double taxation, Taiwan is not able to sign a treaty with the major industrialized countries, such as the U.S., Japan and other European countries, due to their non-recognition of Taiwan as a nation state. Thus, the tax authority of Taiwan has difficulty getting access to the information regarding the taxpayer's foreign-source income. In this situation, should Taiwan adopt the Personal Link System, there would be loopholes with respect to any taxpayer's inappropriate tax evasion or avoidance.¹⁵⁵ In addition, due to the lack of treaties with the major industrialized countries, the Territorial System is adopted in Taiwan in order to gain the revenue benefits.¹⁵⁶ However, even if there were treaties signed between Taiwan and the

¹⁵⁴ See *supra* note 7 at 20.

¹⁵⁵ *Ibid.* at 30.

¹⁵⁶ The Territorial System is only used for any individual having income from sources in the Republic of China (Taiwan). As for any individual who is a resident of the Republic of China, consolidated income tax will be levied in accordance with the income tax law of Taiwan on his/her income derived from sources in the Republic of China. Likewise, for any individual who is a non-resident in Taiwan but who has derived income from sources in Taiwan, unless otherwise provided, income tax payable by him on all such income shall be withheld and paid at the respective sources. (See: Article 2 of the Income Tax Law of Taiwan). On the contrary, for any profit-seeking enterprise operating and having its head office within the territory of the Republic of China, profit-seeking enterprise income tax shall be levied on its total profit-seeking enterprise income derived within or without the territory of the Republic of China. Therefore, in Taiwan, profit-seeking enterprise income tax is levied on the profit-seeking enterprise's worldwide income. Provided that income tax has been paid on the income derived outside of the territory of the Republic of China, in accordance with the tax law of the source country of that income, such tax paid may, upon presentation by the taxpayer of evidence of tax payment issued by the tax office of said source country for the same business year and attested by a Chinese embassy or consulate or other organization recognized by the Government of the Republic of China in the said locale, be deducted from

industrialized countries mentioned above, since the tax rates in these industrialized countries are often higher than those in Taiwan, Taiwan would rarely get revenue after deducting the taxpayer's tax paid in the other country, from his/her tax payable in Taiwan.¹⁵⁷ For political reasons, the Taiwan government's political slogan is '30 million overseas Chinese in the world, go for the government of the Republic of China', so Taiwan adopts the Territorial System. Otherwise, were the Personal Link System employed in Taiwan, these overseas Chinese would very likely give up their citizenship of the Republic of China to avoid double taxation. If so, this would defeat the Taiwan government's foreign policies of maintaining economic and cultural relations with the overseas Chinese and obtaining their patriotism for and recognition of the Chinese government in Taiwan.

3. Conclusion

Different connecting factors, that is 'residence' in Canada and 'income source' in Taiwan, are used by Canada and Taiwan to subject individuals to income tax. Due to the lack of a tax treaty (agreement), it is possible for an individual to pay double tax, in

the amount of tax payable by the taxpayer at the time of filing final returns on the total profit-seeking enterprise income, to the extent that such deduction shall not exceed the amount of tax which is computed at the applicable domestic tax rate. (See: paragraph 1, 2 Article 3 of the Income Tax Law of Taiwan) For any profit-seeking enterprise having its head office without the territory of the Republic of China but having income derived from sources in the Republic of China, profit-seeking enterprise income tax shall be levied on its profit seeking enterprise income derived within the territory of the Republic of China. (See: paragraph 3 Article 3 of the Income Tax Law of Taiwan).

¹⁵⁷ See: The Tax Committee of the Department of Finance of Taiwan, *Income Tax Law and Interpretation Bulletin Board (Suo De Shuei Fa Ling Huei Bian*, in Chinese) (Taipei: The Tax Committee of the Department of Finance of Taiwan, 1994) at 1.

accordance with the tax laws of Canada and Taiwan. As a tax treaty (agreement) can be used to determine which contracting state has the authority to tax and which contracting state shall grant tax credits as a relief, double taxation is avoided. Then, there arises a question of whether Canada and Taiwan can sign a tax treaty (agreement) to avoid double taxation? More details will be provided in the next chapters.

Chapter III

TO GO OR NOT TO GO, THAT'S THE QUESTION!!

1. Introduction

The dilemma of Taiwanese immigrants, that is whether to stay in Canada to keep their right to permanent residency, or to leave to avoid Canada's high tax rates and the double taxation problem by Canada and Taiwan, is discussed in this chapter. It starts with discussion of the impact of the controversial Foreign Reporting Rules¹ (hereinafter referred to as 'the *Rules*') which are said to drive many wealthy immigrants with foreign assets away from Canada. Then the implications of the respective residence issues, 'tax residence' in the *Act* and 'permanent residence' in the *Immigration Act*, R.S.C. 1985, c. I-2 (hereinafter referred to as 'the *Immigration Act*'), will be illustrated. The purpose of this comparative analysis is to explain that the implications of the respective residence concepts, 'tax residence' in the *Act* and 'permanent residence' in the *Immigration Act*, are different, even though they interact with each other.

¹ This is the official title used in the House of Commons of Canada (Second Session, Thirty-fifth Parliament, 45-46 Elizabeth II, 1996-97) Bill C-92, an Act to bring the *Rules* into effect. However, the Foreign Reporting Rules are also known as Foreign Reporting Requirements, Foreign Assets Disclosure Law, or Canada's Offshore Assets Reporting Law ... etc., as seen in the Canadian Federal Budget (February 27) 1995, the Canadian Federal Budget (March 6) 1996, news reports, and periodicals ... etc..

The reasons why some permanent residents surrender their right to permanent residence in Canada, or leave or remain outside Canada for more than 183 days in any one twelve month period, in order to avoid tax, will be illustrated.

This chapter is intended to widen the discussion of double taxation by Canada and Taiwan. The discussion is extended from 'how and why does double taxation come about' to the impact of the controversial Foreign Reporting Rules on immigrants and the tax consequences thereof. Some related issues concerning permanent resident status and citizenship application will also be discussed. The purpose is to enhance a more comprehensive understanding of double taxation by Canada and Taiwan.

2. Impact of the Foreign Reporting Rules

The *Rules* were first introduced in February 27, Canadian Federal Budget 1995 (hereinafter referred to as 'the 1995 Budget'), though little in way of detail was given at that time². In the 1995 Budget, the government simply indicated that it was going to

² The foreign reporting rules were only briefly mentioned in two places in the Canadian Federal Budget (February 27) 1995. Firstly, in Editorial Commentary (by Stikeman, Elliott): Moving Targets (regarding Compliance Measures), it says: '[Offshore Investments]-- Effective for taxation years commencing after 1995, Canadian individuals and corporations who hold or acquire investments outside Canada will be required to disclose considerable additional information regarding their interest in such investments. This information will include: (a) details of transfers to, or deposits with, a foreign corporation, partnership, trust or estate; (b) the name of, and equity percentage in, each foreign affiliate of a resident individual; (c) additional information regarding income earned by a controlled foreign affiliate, including identification of the nature of the income which forms part of foreign accrual property income and the disclosure of whether such income would otherwise have been foreign accrual property income but for a specific provision of the Act; and (d) an annual information return in respect of a non-resident trust to which money or property was transferred from an individual or a corporation resident in Canada or in respect of which a Canadian resident is a beneficiary including the financial statements of the trust as well as information relating to contributions to and distributions from the trust.' Secondly, a similar declaration reappeared in Tax Measures: Supplementary Information, which states: '[Reporting of Ownership of

implement more extensive reporting requirements with regard to the foreign source income of Canadian residents.

The new reporting rules were originally intended to commence on January 1, 1996.³

Therefore, effective for taxation years beginning in 1996, under the *Act*, all Canadian residents are required to disclose specific categories of offshore properties -- both tangible and intangible property must be declared, including shares in a non-resident corporation, interests in a non-resident trust or partnership, and indebtedness owned by a non-resident person, if their respective original costs exceeded CND \$100,000⁴. Canadian residents are

Interests in Foreign Properties]-The budget proposes that Canadian individuals and corporations who hold or acquire investments outside Canada be required to disclose additional information regarding their interests in such investments. These new requirements will provide Revenue Canada with additional information regarding offshore investment made by Canadians, will allow a more efficient administration of the *Act* and will help ensure that Canadian individuals and corporations pay an appropriate amount of Canadian tax on income accruing with respect to their foreign holdings. The new reporting requirements will be effective for taxation years commencing after 1995. Under the proposed requirements, the types of additional information the government will be seeking will include: [a] details of certain transfers to, or deposits with, a foreign corporation, partnership, trust or estate; [b] the name of, and equity percentage in, each foreign affiliate of a resident individual; [c] information in respect of the income earned by a controlled foreign affiliate, including identification of the nature of the income which forms part of foreign accrual property income (FAPI) included in the income of the taxpayer in the year and the disclosure of whether income that would otherwise have been FAPI was considered to be income from an active business by virtue of specific provisions of the *Act*; and [d] an annual information return in respect of a non-resident trust to which money or property was transferred from an individual or a corporation resident in Canada or in respect of which a Canadian resident is a beneficiary; this information return will include the financial statement of the trust as well as information on contributions to and distributions from the trust. Further details of these new requirements will be announced in the coming months and will be subject of consultations with interested parties.' See also: Drache A. ed., "Increased Reporting of Foreign Income" (1996) 18 *The Canadian Taxpayer* 16.

³ Chow, W., "Vancouver business lobby leads fight over tax disclosure--Lawyers cite concerns over privacy as biggest problem", *The Vancouver Sun*, October 1, 1996. A1, A7. However, the time for reporting foreign assets has been extended again and again. See *infra* note 5.

⁴ See: subsection 233.3 (1) of the *Act*, which states that "reporting entity" for a taxation year or fiscal period means a specified Canadian entity for the year or period where, at any time (other than a time when the entity is non-resident) in the year or period, the *total of all amounts each of which* is the cost amount to the entity of a specified foreign property of the entity exceeds \$100,000.

Based on the *Rules*' definition, some specific categories of offshore assets (i.e. specified foreign properties) must be disclosed. It states in subsection 233.3 (1) of the *Act* that "Specified foreign

required to file an information return⁵ with Revenue Canada reporting those foreign properties. 'With respect to offshore holdings, Canadian residents must also file information returns in three other circumstances: (1) when they own an interest in a foreign affiliate⁶; (2) when they transfer or loan property to a non-resident trust⁷ and (3)

property" of a person or partnership means 'any property of the person or the partnership that is (a) funds or intangible property which are situated, deposited or held outside Canada, (b) tangible property situated outside Canada, (c) a share of the capital stock of a non-resident corporation, (d) an interest in a non-resident trust or a trust that, but for section 94, would be a non-resident trust for the purpose of this section, (e) an interest in a partnership that owns or holds specified foreign property, (f) an interest in, or right with respect to, an entity that is non-resident, (g) indebtedness owned by a non-resident person, (h) an interest in or right, under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to any property (other than any property owned by a corporation or trust that is not the person) that is specified foreign property, and (i) property that, under the terms or conditions thereof or any agreement relating thereto, is convertible into, is exchangeable for or confers a right to acquire, property that is specified foreign property, but does not include (j) property that is used or held exclusively in the course of carrying on an active business of the person or partnership (determined as if the person or partnership were a corporation resident in Canada), (k) a share of the capital stock or indebtedness of a non-resident corporation that is a foreign affiliate of the person or partnership for the purpose of section 233.4, (l) an interest in, or indebtedness of, a non-resident trust that is a foreign affiliate of the person or partnership for the purpose of section 233.4, (m) an interest in a non-resident trust that was not acquired for consideration by either the person or partnership or a person related to the person or partnership, (n) an interest in a trust described in paragraph (a) or (b) of the definition "exempt trust" in subsection 233.2, (o) an interest in a partnership that is a specified Canadian entity, (p) personal-use property of the person or partnership, and (q) an interest in or right to acquire a property that is described in any of paragraph (j) to (p).

⁵ The time for reporting foreign assets has been extended again and again. First, Revenue Canada confirmed that it would not require reporting of foreign assets until April 30, 1998, an extension from the original date of April 30, 1997. See: Drache A. ed., "Extension of Time for Reporting Foreign Assets" (1997) 19 *The Canadian Taxpayer* at 35. Later, National Revenue Minister Herb Dhaliwal announced, on September 10, 1997, that 'the government will delay implementation of a rule requiring all Canadian [residents] to report foreign assets over \$100,000 until April 1999'. However, Dhaliwal emphasized that even though the reporting rule has been delayed, Canadian residents are still obliged to pay tax on worldwide income. See: Baines D., "Foreign-asset law put on hold", *The Vancouver Sun*, October 3, 1997. A1.

⁶ According to the Ministry of Finance's press release at the end of 1996, the reporting of foreign affiliates' is '[an] information return [which] will be required to be filed only in respect of foreign affiliates of a taxpayer that are controlled foreign affiliates and foreign affiliates the share of which are owned directly by the taxpayer or a controlled foreign affiliate of the taxpayer. There will also be an exception for dormant or inactive foreign affiliates, the criteria for which are being developed by Revenue Canada.' See: Drache A. ed., "Frenzied Year-end Finance Activity" (1997) 18 *The Canadian Taxpayer* at 186. Also, for the foreign affiliate information return, it says that '[there] will be two foreign affiliate information returns: a detailed return for controlled foreign affiliates and a simplified return for foreign affiliates that are not controlled foreign affiliates. Significant reductions in the compliance burden have been achieved in respect of both returns by recasting the manner in which the information is to be provided to Revenue Canada. *Ibid.* See also: subsection 233.4 (4) of the *Act*.

when they receive a distribution from a non-resident trust.⁸ As explained by Canada's Auditor-General Denis Desautels, the *Rules* 'require Canadians to report foreign bank accounts, rental property outside Canada, foreign securities and interests in foreign trusts, partnerships and other foreign entities. ... [I]ts purpose is to give Revenue Canada a more complete picture of taxpayers' offshore investments so it can verify their tax returns.'⁹ It can be concluded that Revenue Canada has established rules and will enforce them and look closely, for tax purposes, at the worldwide income of Canadian residents¹⁰, which, of course, includes immigrants. However, new immigrants will not be required to file foreign property information returns for the year in which they first become resident in Canada.¹¹ Other than that, the federal government imposes stiff penalties for non-compliance by Canadian residents.¹²

⁷ See: subsection 233.2 (4) of the *Act*.

⁸ See: subsection 233.6 (1) of the *Act*. According to Strategy Institute documents, there are two conditions that must exist for the government to tax the passive investment income and taxable capital gains earned by a trust which is not resident in Canada: (1) There must be at least one person resident in Canada who may receive income or capital distributions from the trust. (2) The trust must have received property from someone who is resident in Canada who is related to the beneficiary previously mentioned. See: Chevreau J., "Foreign-asset Reporting Requirement debuts in 1998", *Financial Post*, November 29, 1997.

⁹ Yiu G., "Commentator says auditor-general is right about asset reporting -- The critics are wrong about the controversial tax-legislation requirement. It is not why wealthy foreign investors are shunning Canada. Our tax rates and fiscal policies are.", *The Vancouver Sun*, June 10, 1998. A17.

¹⁰ Hogg P.W. & Magee J.E., *Principles of Canadian Income Tax Rules* (Ontario: Carswell, 1997) at 112.

¹¹ See: section 233.7 of the *Act*, which states: '[Exception for first-year residents]--Notwithstanding sections 233.2, 233.3, 233.4 and 233.6, a person who, but for this section, would be required under any of those sections to file an information return for a taxation year, is not required to file the return if the person is an individual (other than a trust) who first became resident in Canada in the year'. See also: the 'History' of section 233.7 of the *Act* in Pound R.W., ed., (editor in chief), *Income Tax Act*, 26 ed. (Ontario: Carswell, 1997) at 1775.

¹² In the Canadian Federal Budget (March 6) 1996, in cases of 'Interests in Foreign Property' (Form T1135) and 'Shares in Foreign Affiliate' (Form T1134), the penalty was firstly announced as a minimum penalty of \$500 per month, for up to 24 months, prescribed for failure to file as required. In addition, a

2.1 Comments on Foreign Reporting Rules

Some commentators have noted that the *Rules* are inappropriate, and the problems include the following:¹³

2.1.1 The foreign reporting rules are a violation of privacy

A critic said that [under the new rules], 'the Canadian residents will be required to disclose their offshore assets, including businesses, joint ventures, shares, real estate

further penalty is imposed for not filing within two years. This is set at an amount equal to 10% of the cost of the taxpayer's foreign property, cost of shares in the foreign affiliate, minus the \$12,000 initial penalty. In the case of 'Distributions from Foreign Trusts' (Form T1142), the minimum penalty is \$25 per day, for up to 100 days. Additional penalty in this case is not applicable. In the case of 'Transfers and Loans to a Foreign Trust' (Form T1141), the minimum penalty is \$500 per month, for up to 24 months. A further penalty is imposed for not filing within two years, which is set at an amount equal to 10% of the amount that the taxpayer transferred or loaned, minus penalty otherwise determined. Further penalties may be changed for making a false statement or omission in any such return. The above penalties are, of course, in addition to any penalties that may be imposed for tax evasion arising out of the failure to declare taxable foreign-source income'. See: The Canadian Federal Budget, March 6, 1996. See also: Easson A., "Focus on International Tax -- Reporting Offshore Assets" (1996) 6 Canadian Current Tax.

Later on, some changes were announced in the new foreign reporting rules which offer a modicum of relief. According to the Ministry of Finance's press release at the end of 1996: (1) Penalty for failure to file for more than 24 months: the penalty for failure to file an information return required to be filed under any of section 233.2, 233.3, and 233.4 of the *Act* for more than 24 months is reduced from 10 per cent of the cost of certain foreign property of the taxpayer to 5 per cent of the cost of such property. The penalty will apply only where the failure to file is done knowingly or is attributable to gross negligence. (2) Penalties for failure to file: The penalty for the simple failure to file an information return will be \$25 per day for up to 100 days (\$2,500 maximum) under existing subsection 162(7) of the *Act*. The larger penalties for failure to file an information return, i.e., \$500 per month for up to 24 months and 5 per cent of the cost of certain foreign property after 24 months, will apply only where the failure to file is done knowingly or under circumstances amounting to gross negligence. See: Drache A. ed., "Frenzied Year-end Finance Activity" (1997) 18 The Canadian Taxpayer at 186.

¹³ See *supra* note 9. See also: Chow W., "Petter joins opposition to overseas asset reporting law", The Vancouver Sun, September 20, 1997. A1. See also: Baines D., "Group felt law violated privacy", The Vancouver Sun, October 3, 1997. A2.

holdings, bank accounts and other investments, if they exceed \$100,000 ... [The new reporting rules are a violation of privacy, because] currently [in 1996, before the new rules were passed], they need only to report and pay taxes on worldwide income'.¹⁴ This comment fails to point out how and why the Canadian residents' privacy is violated by the *Rules*. In addition, no objective evidence was provided. On the contrary, a senior research associate for the non-profit Canadian Tax Foundation says that the rules, described as an invasion of privacy, '[are] not unprecedented in terms of tax systems. [W]here there are net wealth taxes, as there are in many European countries, there is a requirement to fully spell out your assets'.¹⁵

The definition of privacy in a legal context, provided by Alan F. Westin, is that '[p]rivacy is the claim of individuals, groups or institutions to determine for themselves when, how, and to what extent information about them is to be communicated to others'.¹⁶ However, 'whether privacy is a right, an interest or a value has been much debated over the years, and even today, after much attention has been focused on this topic, we are far from achieving a consensus as to its nature'.¹⁷ Even so, some opponents of the *Rules* have

¹⁴ Chow W., "Vancouver business lobby leads fight over tax disclosures -- Lawyers cite concerns over privacy as biggest problem", The Vancouver Sun, October 1, 1996. A7.

¹⁵ Baines D., "Growing number of Canadians do business offshore", The Vancouver Sun, October 4, 1997. F8.

¹⁶ Cohen S.A., "Invasion of Privacy: Police and Electronic Surveillance in Canada" (1982) 27 McGill Law Journal 619 at 662.

¹⁷ *Ibid.*

suggested that the *Rules* may violate the *Charter of Rights and Freedoms*¹⁸ and are an intolerable invasion of privacy.¹⁹ These opponents also suggest that the *Rules* would discriminate against Canadians who own foreign assets.

Subsection 231.6(2) of the *Act* states that 'the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign based information or documents'.²⁰ In my view, this subsection grants the Minister extremely broad powers to get access to the individual's foreign assets information and documents. However, the Minister is limited in that his power must be exercised for the purpose of administration of enforcement of the *Act*. As pointed out above, there is no consensus as to the true nature of privacy, and whether privacy is a right or not. Therefore, it is hard to judge whether the *Rules* are a violation of privacy and to what extent the privacy is violated. Even so, it is understandable that the *Rules* are suspected being a violation of privacy, as some commentators have noted that 'not even the worst communist dictatorship requires citizens to report their personal assets annually. This is an important perception. People flee communist states because they fear the ownership of personal assets will not be

¹⁸ See: *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c.11.

¹⁹ Loh M., "Foreign-asset Disclosure is a Bad Idea", *The Vancouver Sun*, July 9, 1998. A19. (Forum)

²⁰ See: subsection 231.6(2) of the *Act*.

respected. Oppression by the state often starts with the encroachment of private property rights'.²¹

2.1.2 They are a forerunner of a wealth tax

Another concern about the *Rules* is the fear that they are a forerunner of a wealth tax.²²

The principle underlying wealth tax is that income is not the only measure of a person's ability to pay taxes, the mere possession of wealth or property represents an addition to ability to pay.²³ Therefore, it seems obvious that 'if taxes should be levied in accordance with ability to pay, an income tax should be supplemented by a wealth tax'.²⁴

Furthermore, '[t]he case for a wealth tax, does not need to depend upon a desire to reduce large concentrations of wealth and to make the distribution of wealth in Canada more even, although those goals presumably also appeal to most people. The case for a wealth tax may be rested simply upon the proposition that taxes should be levied in accordance

²¹ See *supra* note 19.

²² Wealth is a state of having abundant financial resources and properties. All material objects, capable of satisfying human wants, desires, or tastes, having a value in exchange can be regarded as wealth. See: *Black Law's Dictionary*, 6th ed. by Black H. C. (St. Paul, Minn. : West Publishing Co., 1990) at 1593. Wealth should also be taken account of in the income computation because wealth taxes are required in order to redistribute the 'extra benefits' in terms of prestige, security, influence, and opportunity derived from wealth holding, and especially from large wealth accumulation. Wealth taxation has been justified mainly on grounds of horizontal equity, vertical equity, and equality of opportunity. See: Head J.G. "Tax-Fairness Principles - A Conceptual, Historical, and Practical Review" in *Fairness in Taxation* at 48. Wealth taxes are regarded as appropriate because of the fairness requirement in a democratic society, which, if functioning efficiently, should not function in favour of the pursuit of sectional or some individuals' self interests. *Ibid.* at 48.

²³ See *supra* note 10 at 112.

²⁴ *Ibid.*

with ability to pay. In other words, in order to raise the government's revenue requirements as fairly as possible, there is a place for a wealth tax in the mix of taxes that should be levied'.²⁵ According to this principle, since the taxpayers with foreign assets have more ability to pay, a wealth tax shall be imposed on them. However, under the current Canadian income tax system, there is no wealth tax in the form of estates taxes or succession duties.²⁶ Nevertheless, Revenue Canada believes that, with the *Rules*, it will be easier to track income or conduct audits, and the main goal of the *Rules* is to increase revenue and make sure all the Canadian residents fairly pay their share of tax. It can be concluded that the more foreign assets a taxpayer owns, the more he/she is taxed, at a progressive rate,²⁷ regardless whether it is called wealth tax or not.

²⁵ *Ibid.*

²⁶ Therefore, one commentator has noted that '[i]n Canada, all taxes on wealth transfers have now been abolished'. See: Head J. G., "Tax Fairness Principles -- A Conceptual, Historical, and Practical Review" in Fair Tax Commission, *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission* (Toronto: University of Toronto Press, 1993) at 52. In the traditional literature, wealth taxes are levied through both the annual tax on net wealth and the tax on wealth transfers by bequest or gift. *Ibid.* at 47 - 54. Canada taxes 3/4 of capital gain on disposition, which is a transfer. It can be concluded that, generally speaking, Canada has no wealth tax as such, but Canada does tax some wealth transfers.

'A wealth tax could take the form of a periodic levy based on the assessed value of all of each taxpayer's property; such a levy could be imposed annually, or every five years, or other recurring date. ... In Canada, the municipal taxes on real estate are a limited form of periodic wealth tax, as are the federal and provincial capital taxes on large corporation, but Canada (like the other common law countries) has never attempted to levy a periodic wealth tax on all types of property. It has always been assumed that the task of valuing all of a person's wealth is too difficult and controversial to be undertaken with any frequency. Traditionally, therefore, wealth taxes in Canada (and elsewhere in the common law world) have taken the form of wealth transfer taxes that are levied only when wealth is transferred, either on the death of the owner [a death tax] or when the wealth is given away [a gift tax]. ... A gift tax is usually regarded as a supplement to a death tax to prevent the erosion of the death tax base by inter vivos gifts'. See *supra* note 10 at 146. In Canada, the federal estate and gift taxes were repealed in 1971, and as September, 1998, no jurisdiction in Canada levies a death tax or a gift tax. Therefore, one commentator has also noted that, in Canada, all taxes on wealth transfers have now been abolished. *Ibid.* at 146 - 147.

²⁷ Using progressive tax rates when levying the income tax is well-accepted in order to redistribute social resources, especially via public-expenditure programs of the welfare state in such areas as education and income support. The tax system is used as an instrument to raise revenue to finance government expenditures, and since progressive rates have most impact on the rich, the tax system can be regarded as functioning as a tool to redistribute wealth. The government's redistributive function might embrace one or both of two different conceptions. Stated in the form of questions, they are: (1) to what extent should

2.1.3 They unfairly target wealthy new Canadians and drive wealthy immigrants out of Canada

Some commentators also point out that the *Rules* were intended to catch Canadian residents who move assets to evade tax²⁸. However, the *Rules* ran into their stiffest

the government raise the living standards of low-income individuals or families? and (2) to what extent should the government attempt to reduce the inequalities between the rich and the poor by reducing the income and wealth of the rich? See: Brook N. "The Changing Structure of The Canadian Tax System: Accommodating the Rich" (1993) 31 Osgoode Hall Law Journal at 157. To achieve the redistributive function of making the economy more equitable, progressive rates are necessarily applied to the rich. That is why the Australian economist R.L. Matthews stated that: '[n]early all the factors which inhibit horizontal equity, neutrality, simplicity, certainty, and tax effectiveness... have their origin in the attempt to use progressive income taxes as the means of the achievement of income redistribution'. See: Matthews R.L., "Tax Reform in English-speaking Countries" (1988) 6 Environment and Planning C: Government and Policy 1 at 4.

In order to further increase the neutrality of income tax on individuals, the Canadian government also converted a number of tax deductions into tax credits: the basic personal exemption, the married and equivalent-to-married exemption, the exemption for supporting child dependents, the age exemption, the disability exemption, the \$1,000 pension income deduction, the deduction for contributions to the Canadian Pension Plan and premiums for unemployment insurance, the deduction for medical expenses, the deduction for tuition fees and the \$50 per month deduction as an educational allowance, and the deduction for charitable donations. See: Brook N. "The Changing Structure of The Canadian Tax System: Accommodating the Rich" (1993) 31 Osgoode Hall Law Journal at 155. Converting tax deduction into credits would appear to make the tax system more progressive since tax expenditures delivered as deductions benefit high-income taxpayers more than tax expenditures delivered as credits. A deduction reduces a citizen's taxable income and, therefore, the amount of tax that is saved is related to the taxpayer's marginal tax rate. The higher the taxpayer's marginal tax rate, the greater the savings. A tax credit, in contrast, is deducted directly from a taxpayer's tax owing and therefore saves all taxpayers the same amount regardless of their income and their marginal tax rate. *Ibid.* at 155 - 156. The rich have been the primary beneficiaries of the subsidies delivered through the tax system. Therefore, reducing these subsidies, or converting them from tax deductions to tax credits, might appear to be equitable. However, when these changes were made, the rich still benefited. For example, although converting tax expenditures from deductions to credits reduced their value to high-income taxpayers, the rich were more than compensated for this loss through marginal tax rate reductions. Indeed, the government was careful to ensure that all the changes taken together -- the base-broadening measures and the rate reductions -- would be distributionally neutral. *Ibid.* at 156.

²⁸ Tax evasion involves failure to pay tax that is due under the tax law. In most countries, tax evasion that involves willful or intentional fraud or deceit is a criminal offense. Unintentional evasion is usually subject only to payment of the tax due with interest and penalty. See: Arnold B.J. & Wilson J.R., "The General Anti-Avoidance Rule -- Part I" (1988) 36 Canadian Tax Journal 829 at 873.

opposition from wealthy Asian immigrants who had moved to Canada but still owned assets abroad.²⁹ A joint presentation made in July, 1996 by the Canadian Bar Association and the Canadian Institute of Chartered Accounts to Finance Minister Paul Martin said that '[w]hile the new reporting requirements affect all Canadians, many well-heeled Asians are less likely to tolerate them since they came from countries where it is not necessary to disclose assets, or be taxed on income derived from assets ... [P]eople don't mind disclosing income, but they don't want to disclose assets to any government ... New comers [to Canada] who have no strong roots would be inclined to leave'³⁰ ... '[T]here were numerous media reports that the reporting rules were driving wealthy immigrants from Canada and deterring new immigrants from coming to Canada'³¹. Aside from that, the Taiwanese-Canadian Culture Society also said that 'there is a real concern that we were received negatively among the business immigrant community, prompting people to reassess whether they want to stay or invest in Canada'.³² However, without careful study, all statements on this matter are just conjectures. Even if they are accurate, they only reflect the decisions of some people.³³

²⁹ Baines D., "Group felt law violated privacy", The Vancouver Sun, October 3, 1997. A2.

³⁰ See *supra* note 14.

³¹ See *supra* note 29. This report quoted the comments made by Maurice Levi, UBC finance professor and the conductor for the Laurier Institution report, that '[o]n one hand, the rule might improve compliance and increase tax revenue. On the other hand, it might drive immigrants away and decrease tax revenue'.

³² See: Chow W. "Some of Martin's concessions applauded", The Vancouver Sun, December 7, 1996. B14. [The minister's concession here refers to is a one year extension of the reporting deadline to April 30, 1996, (later, it was extended again to April, 1999, announced by National Revenue Minister Herb Dhaliwal on September 10, 1997) and a due diligence exception that will exempt people from penalties for omissions in tax returns if the taxpayer has made adequate efforts to obtain required information.] For the 'due diligence exception', see: section 233.5 of the *Act*.)

³³ A survey that raises questions about the extent to which the federal government's offshore assets reporting rules are driving Hong Kong and Taiwanese immigrants away from Canada has been released

2.1.4 The \$100,000 limit is too low; it discourages foreign investors

Opponents of the *Rules* have complained that the \$100,000 limit is too low. 'The \$100,000 [threshold] is extremely low. ... It's going to catch a lot of people in the net'.³⁴ Many middle-class individuals -- 'small fish'-- would even be caught by the \$100,000 threshold, 'since in some places in Asia, a parking space could cost that much'.³⁵ 'Those who may only own a summer residence somewhere [if it is not within the categories of exceptions from reporting under subsection 233.3 (1) of the *Act*] could wind up being caught by the \$100,000 threshold as well'.³⁶ Therefore, some critics suggest that the

by the Toronto-based polling firm ACNielsen-DJC Research. It said that although Vancouver media have reported that tens of thousands' of immigrants have fled Canada to avoid the reporting rule -- which requires Canadian residents to report offshore assets exceeding \$100,000 -- the ACNielsen survey does not support this contention. According to their research, of 2,001 Hong Kong and Taiwanese Canadian residents surveyed in Vancouver and Toronto, only 3.5 per cent said they were contemplating moving back to their home countries. Of that 3.5 per cent, one third said their main reason for leaving was difficulty finding a good job in Canada. Another 20 per cent said they were motivated by high taxation levels in Canada. Not one respondent cited the offshore reporting requirement.

In addition, opponents of the asset reporting rule also say that 'it not only drives immigrants away, it deters them from moving here.' However, according to Frank Ip, senior immigration analyst with B.C. Stats, 'the number of Hong Kong immigrants to B.C. [Canada], peaked in 1994 and has remained relatively stable from 1995 to the first half of this year. Meanwhile, the number of Taiwanese immigrants has steadily risen'. The statistics do not support the opposition. See: Baines D., "Impact of law on immigrants hard to assess", *The Vancouver Sun*, October 3, 1997. A2. On the other hand, Canadian commissioner Garrett Lambert confirms that applications for immigration to Canada have dropped 15 per cent in the first quarter of 1997, after an 18 per cent decline in 1996 over the previous year. See: Chow W., "Assets measure aimed primarily at Canadians who use overseas tax havens", *The Vancouver Sun*, June 13, 1997. E2. However, since no further study has provided reasons to explain the decline, the statistic loses meaning, as there is no proof that the decline is due to the foreign assets disclosure law coming into force.

³⁴ See *supra* note 14.

³⁵ *Ibid.*

³⁶ See: Chow W., "Amendments to Income Tax Act remain on backburner after protests", *The Vancouver Sun*, February 6, 1997. D8. However, this comment might be a misunderstanding, because personal-use property is not required to be declared, unless, presumably, it also produces rental income. See *infra* note 70.

threshold be increased to \$1.5 million, but this has not been accepted by the Ministry of Finance.³⁷ The fear expressed by the critics is that the low threshold will discourage foreign investors. The *Rules* were not devised with immigrants in mind;³⁸ instead, they are intended to curb the schemes of those Canadian residents who attempted to place investments offshore with no Canadian tax to pay and no supposed Canadian ownership of the trusts.³⁹ That is to say, the *Rules* are motivated by the growing popularity of tax havens and are aimed to curb tax evasion by Canadian residents. It is not the business class immigrants who are coming in to invest who are evading taxes, it is the Canadian residents who are moving money offshore, said David Perry, senior research associate for the non-profit Canadian Tax Foundation.⁴⁰ Many potential business class immigrants who are considering immigrating to Canada have assets in their original countries, which are regarded as 'foreign assets' after they land in Canada, due to the emergence of the *Rules*. It is said that these investors have gone to Australia instead,⁴¹ and in the long run, it might hurt the economic development of Canada.

³⁷ For example, Jock Finlayson, a vice-president of the B.C. Business Council, who said that '[t]he \$100,000 threshold is extremely low, it's going to catch a lot of people in the net ... it may turn out to be a mistake'. See *supra* note 14. He said his group supports a bid to have the assets reporting threshold increased to \$1.5 million -- the same threshold as B.C.'s unpopular corporation capital tax, which the business council opposes.

³⁸ See *supra* note 15.

³⁹ See *supra* note 8.

⁴⁰ See *supra* note 15.

⁴¹ Chow W., "New asset tax driving immigrants from Canada", The Vancouver Sun, October 11, 1996. D6.

2.1.5 An alternative to improve compliance and increase revenue

One commentator has noted that the departure of business immigrants, driven by the *Rules*, has affected B.C. more than any other province, as half of all business immigrants to Canada in the 90's have settled in B.C..⁴² B.C. Finance Minister Andrew Petter joined the fight to persuade the federal government to scrap Revenue Canada's controversial foreign reporting rules and find an alternative, by personally delivering a letter to federal Finance Minister Paul Martin calling on Ottawa to abandon the legislation. '[I] urge you to withdraw the new reporting requirements for foreign assets and instead initiate a true consultative process to search for a more acceptable and effective alternative ... [T]he uncertainty surrounding this law has led to fears of increased taxation and appears to have weakened Canada's international reputation as an attractive place for individuals to reside and invest'.⁴³ In addition, some commentators have noted that '[w]e very strongly support the principle that everybody should pay taxes on offshore income. However, the method to achieve that should be appropriate and similar to other jurisdictions around the world ... [w]e proposed from the outset an alternative system, a comprehensive audit system, rather than throwing a large net where everyone is required to report all offshore assets over \$100,000'.⁴⁴ In short, these opponents urged an alternative similar to that

⁴² The comment was made by Mason Loh, a Vancouver lawyer and Queen's counsel. See *supra* note 19.

⁴³ See: Chow W., "Petter joins opposition to overseas asset reporting law", *The Vancouver Sun*, September 20, 1997. A1.

⁴⁴ See *supra* note 29.

used in other countries to improve compliance and increase revenue in the tax system of Canada.

The *Rules* have created tremendous controversy and prompted Finance Minister Paul Martin to repeatedly delay implementation and, to appoint Auditor-General Denis Desautels to review the proposal (of the *Rules*).⁴⁵ Faced with these comments on and debate over the *Rules*, Auditor General of Canada Denis Desautels has responded to defend the *Rules*. However, he seems to be satisfied with the *Rules* and does not appear to intend to make any change. For example:

The Auditor-General's response presented in Dec., 1997 was as follows:

'(1) The requirement is an appropriate mechanism within an over-all strategy of enhancing compliance with laws that require reporting of foreign-source income and of providing Revenue Canada with information to verify taxpayer's self-assessments. We note that the requirement is a compliance tool and does not impose any new taxes. At the same time, we believe that some modifications should be considered.

(2) We asked department officials and those who made submissions to suggest alternatives. We examined all that were suggested to us and have grouped them into three alternatives. We concluded that repealing the requirement and increasing enforcement would not meet many of the objectives set for the reporting requirement. In addition, without information it is difficult to target audits, which would diminish the prospects for success. The suggestion that new immigrants be allowed to negotiate their Canadian tax liabilities on foreign-source income for a period of time is not a viable alternative, primarily for equity reasons.

(3) We studied the serious and deep-felt concerns that taxpayers raised about privacy, economic and investment issues. We found that many of the concerns had their root cause in Canada's relatively high tax rates, its requirement to pay tax on worldwide income and a poor understanding of Canada's tax system. It was appropriate to us that

⁴⁵ See *supra* note 19.

while the reporting requirement was a fiscal point, it was not the main concern.⁴⁶

Later on, in July, 1998, the Auditor General again responded to the questions raised by a Vancouver Lawyer, Mason Loh, by defending the *Rules* as follows:

‘(1) The reporting requirement does not change Canada’s tax structure, It does not increase the tax burden; it is a compliance tool. The reporting requirement is designed to encourage and facilitate self-assessment, the principle on which our tax system is based. Enforcement programs such as audit and investigation are designed to supplement the system, not to serve as alternatives.

(2) [The main goal of the *Rules* is to curb attempts at tax evasion]. Tax evasion occurs when a taxpayer seeks to defraud the tax collector. It is a serious offense, a direct attack on the integrity of the tax system and, when left unchecked, threatens to undermine the values on which our self-assessment system is based.

(3) [The *Rules*] will enable Revenue Canada to better scrutinize offshore investments and ensure that the income they produce is reported fully. The biggest impact will be on those who -- while not deliberately seeking to evade taxes -- are nonetheless not complying with the law. For example, a taxpayer who purchased an offshore investment on the understanding that its income was not taxable in Canada would not have reported the income. However, once the investment has been reported and Revenue Canada has had an opportunity to investigate, it could conclude that the investment income was taxable. Another example is Canadians who do not fully understand the tax laws. They are not seeking to evade taxes, but they are not complying with the law if they do not report their foreign-source income.

(4) [The *Rules* would not undermine Canadian’s efforts to attract immigrant investors.] [The *Rules*] do not discriminate against immigrants; everyone is treated equally. Every resident is subject to the reporting requirement. Canada allows a significant tax concession to new Canadians through use of an offshore trust. A non-resident trust can be set up by individuals before immigrating. Any or all of the individual’s offshore investments can be placed in it. Even though it is now possible to apply for Canadian citizenship and a passport after three years as a Canadian resident, as long as the investments are left in the trust and are not brought into Canada, the income they generate will not be taxed in Canada for a period of five years. This effectively provides a new Canadian with relief for five years from taxes on all income from investments held in an offshore trust. Canada also allows new immigrants to ‘set up’ the cost basis of their assets for capital gains and depreciation purposes.

⁴⁶ See *supra* note 9.

(5) The concern that it is an intolerable invasion of privacy and discriminates against Canadians who own foreign assets is, in our view, unfounded. It is no more invasive to ask taxpayers to report their foreign assets than it is to ask them to report the investment income those assets yield. Millions of Canadians whose sole source of income comes from wages or from domestic investments have that income reported directly to Canada. In addition, millions of Canadians receiving wages have tax deducted and sent directly to Revenue Canada. They could argue that the reporting requirement is far less invasive than are the rules that apply to them.

(6) [We do not agree with the critic which says that the *Rules* are one of the 'most onerous' in the Western world.] The Organization of Economic Co-operation and Development recently released a report, which Canada supported, recommending countries that do not have rules for reporting international transactions and foreign operations of resident taxpayers consider adopting such rules, and that countries exchange the information obtained under these rules. In the G7 heads of state's communiqué in 1996, they urged the OECD to vigorously develop measures to counter the distorting effects of harmful tax competition on investments and financing decisions as well as the consequences for national tax bases.

(7) The reporting requirement is not a disincentive to invest in Canada but rather Canada's relatively high tax rates and broad tax base are. Many new Canadians are not used to paying such a large portion of their income in tax and they clearly dislike it. They also dislike paying Canadian taxes on income earned on wealth acquired before they became Canadian residents. But the reporting requirement does not change Canada's tax structure; it is simply a compliance tool to level the playing field between domestic and foreign source income. Notwithstanding that it is impossible to calculate the possible loss of revenue associated with the unreported foreign-source income, we are satisfied that there is non-compliance with the requirement. We are not prepared to ignore them, and we believe that the vast majority of Canadians do not want them ignored'.⁴⁷

2.2 *My Perspective*

2.2.1 The tax burden is brought into sharp relief by the Foreign Reporting Rules

⁴⁷ See: "Foreign asset law is OK, says Auditor General", The Vancouver Sun, July 25, 1998. A23 (Forum).

The tax burden in Canada has been supported less and less by corporations and more and more by individual tax payers. For example, in the House of Commons, Mr. Roger Pomerleau has noted that:

In 1952, corporations contributed 51 per cent of the taxes paid to the government, compared to 45 per cent for individuals. In 1962, 10 years later, corporate taxes amounted to 36 per cent of the total; in 1972, it was 20 per cent; in 1982, it was down to 18 per cent, and, in 1992, it was a mere 7.6 per cent. We can see that, over the past 40 years, corporate taxes have steadily gone down, while personal taxes have increased.⁴⁸

Moreover, one commentator has noted that '[in Canada,] [t]he most important source of government revenue is the personal income tax: on a financial management system basis, it accounted for 33.5 per cent of consolidated revenue for all governments in 1993-94'.⁴⁹ And, 'from 1934 to 1994, the number of taxpayers grew from fewer than 200,000 to nearly 13.7 million'.⁵⁰ With respect to the importance of personal income tax in Canada, the commentator has also noted that '[t]he personal income tax is much more important to the federal revenue structure now than in the pre-World War II period. In the 1996-97 fiscal year, about 45 percent of the total federal budgetary revenue of \$135.1 billion will come from the personal income tax compared with only 8 percent in 1939-40'.⁵¹ In these circumstances, as the *Rules* are targeted on Canadian residents who deliberately evade tax,

⁴⁸ *House of Commons Debates* (18 April 1997) at 9926. (by Mr. Roger Pomerleau)

⁴⁹ Treff K. & Perry D.B., *Finances of the Nation 1997* (Toronto: Canadian Tax Foundation, 1997) at 3:1.

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

it can be predicted that the implementation of the *Rules* will increase revenue and the tax burden will be brought into sharp relief by the *Rules*.

2.2.2 The *Rules* are not a cure all for tax evasion

The *Rules* are not a cure all for tax evasion. For example, for interest gained from foreign branches of Canadian banks, it now appears that at least one part of the plan involves requiring these foreign branches of Canadian banks to issue T-5 slips with regard to interest paid to Canadian residents. While the *Rules* are consistent with the drive to find previously unreported income, the decision opens the doors to a kind of reciprocity -- namely, that foreign countries may require Canadian resident branches or subsidiaries to adhere to their reporting requirements. Up to now, this has been resisted by Canada as an infringement on sovereignty.⁵² In addition, as far as Canadian banks are concerned, there are two issues. Undoubtedly, there will be some countries where bank secrecy laws would penalize the issuing of T-5s as a breach of secrecy requirements. More to the point, they are left with a situation where a Canadian resident can avoid the T-5s by simply using a non-Canadian bank.⁵³

⁵² Drache A. ed., "Increased Reporting of Foreign Income" (1996) 18 *The Canadian Taxpayer* at 16.

⁵³ *Ibid.*

The foreign reporting rules are aimed to prevent Canadian residents from evading tax.⁵⁴

In other words, Revenue Canada's main aim is to stop the flow of billions of dollars each year from Canadian residents and large Canadian corporations into overseas tax havens⁵⁵,

⁵⁴ As National Revenue Minister Herb Dhaliwal said: 'the *Act* requires Canadian residents must report any income from any source, including any income earned abroad. Because there are no controls, there is no way of knowing what assets are abroad, and there is no way of making sure people report all their income. That's the essence of those offshore trusts, which are really tax-cheating schemes'. See: Baines D., "Growing number of Canadians do business offshore", *The Vancouver Sun*, October 4, 1997. F8. This report also points out that '[o]ffshore accounts have long been a favorite vehicle of stock-market players who want to hide their trading activities from regulatory and tax authorities ... Tax experts say that offshore companies are often established as trusts with non-taxable charities designated as beneficiaries. This allows income to accrue to the trust on a tax-free basis. It also enables the real owners to tell the tax department they have no beneficial interest in the trust. In fact, they usually have a tacit agreement with the trust adviser that, when assets are distributed, they will replace the charities as the beneficiaries'.

⁵⁵ Generally, tax havens are countries with no or very low rates of taxation. This definition focuses on the comparison of tax rates between the foreign country and the home country. When the foreign country's tax rate is substantially less than the domestic rate, the foreign country could be regarded as a tax haven. As mentioned above, tax havens typically are countries with no or a very low rate of taxation. However, a generally high-tax jurisdiction can also be a tax haven with regard to a particular operation or situation. See: Organization For Economic Co-Operation and Dev., *Issues in International Taxation No. 1, International Tax Avoidance and Evasion 30* (1987). [hereinafter OECD Study]. Actually, tax haven possibilities arise when treaties and national tax law combine, in ways often unanticipated by their framers, to create a uniquely favorable tax regime for a certain class of transactions. See: Yang C., "Taiwan's Control of the Tax Sheltering Use of Tax Haven Base Companies: Substance over Form Rule or Subpart F-Type Legislation?" (1993) 31:231 *Columbia Journal of Transnational Law* 231 at 235 - 236. [hereinafter Yung C., 1993].

Tax havens may be used at two levels. On the individual level, a person may emigrate, shift personal residence, and transfer assets to a tax haven. See: Yang C., 1993 at 234. The second level is the entity level, which consists of setting up a corporation in a tax haven, or having the corporate seat, such as the place of management or the meetings of the board of directors, in a tax haven. *Ibid.* The business reasons for locating a company in a tax haven could be both for the tax haven's (1) beneficial tax attributes, and (2) non-tax attributes. Tax havens are known for their beneficial tax attributes. Langer lists four non-tax benefits which are: (i) confidentiality; (ii) freedom from currency controls; (iii) freedom from banking controls; particularly the reserve requirements; and (iv) receipt of higher interest rates on bank deposits and borrowing at lower interest rates. See: Langer, *Practical International Tax Planning* (3rd ed. 1985 & Supp. Dec. 1991) app. A at A-16 to A-18. [hereinafter Langer, 1991] Examples of these non-tax benefits include: a high level of banking and commercial secrecy, which provides enterprises with high levels of confidentiality often absent in the owners' home countries, very loose foreign exchange control, and a large and sophisticated financial service sector. See: Langer, 1991, app. A at A-29 to A-31; see also: OECD Study at 23. Tax havens' strict confidentiality laws are often condemned by non-tax haven countries for creating criminal hideaways. See: Yung C., 1993 at 235 - 236. However, their lack of exchange control and abundance of banks are often justified as promoting international finances. Banking is just one of these advantages recognized by the Business and Industry Advisory Committee of the OECD. Other 'suitable' businesses include pension funds, patent holding, captive insurance, and shipping because they can benefit from the non-tax attributes in tax havens. *Ibid.*

such as the Cayman Islands, Bermuda, the British Virgin Islands, the Channel Islands, Liechtenstein and Switzerland.⁵⁶ However, as Alex Easson said, then Revenue Minister Jane Stewart was probably being excessively optimistic in claiming that 'We will make sure that all Canadians report income earned outside the country'.⁵⁷ This is especially true 'if one avoids investing in countries, or in the type of assets, where automatic exchanges of information between tax authorities make it difficult to conceal such income, then tax evasion becomes relatively easy'.⁵⁸ Since Taiwan and Canada have no treaty between them, the goal of the foreign reporting rules, to improve compliance and increase revenue, seems to be somewhat ambitious. It can be concluded that, in this circumstance, 'there is not a great deal that the tax authorities can do to prevent such evasion, other than to make the penalties in the event of discovery sufficiently severe that all but the most determined evaders will be deterred'.⁵⁹

2.2.3 Some changes to the *Rules* are needed

⁵⁶ Tax havens can be divided into three categories: (i) No tax havens: where there is no tax at all; examples are: Bahamas, Bermuda. (ii) Low tax havens: where only a low rate of tax is imposed (often coupled with an exemption for non-domestic income); examples are: British Virgin Islands, Hong Kong. (iii) Tax havens with special privileges: where the tax system favours particular entities or types of activity; examples are: Luxembourg, Panama, Switzerland. See: Davies D.R., *Principles of International Double Taxation Relief* (1985) at 9. In Taiwan, the first type tax haven is called 'tax paradise', the second 'tax shelter' and the third 'tax resort'. See: Wang J.S., *Taxation Law (in Taiwan)*, 20 ed. (Taipei: Wen-sheng Publishing Company, 1996). Mr. Wang, formerly R.O.C.'s Minister of Finance, directed the Taiwanese government's crackdown on companies engaged in tax haven planning. See also *supra* note 55 (Yang C., 1993) at 234.

⁵⁷ See: Easson A., "Focus on International Tax--Reporting Offshore Assets" (1996) 6 Canadian Current Tax at 76.

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

Some changes⁶⁰ are needed in order to change Canada's investment climate and the perceptions of foreign investors.⁶¹ While Revenue Canada claims the measures of the *Rules* are aimed primarily at Canadians who evade income taxes by hiding assets in overseas tax havens, many Asians believe they are being targeted.⁶² As for the disclosure of assets, people like the Chinese with a history of having their assets confiscated by the Communists are understandably 'reluctant to disclose all their assets'.⁶³ This can also explain why a critic said that '[i]f Canada had handled it right, a lot of Hong Kong money that went to England because of the [July 1, 1997] handover would have come here [Canada]. 200,000 Hong Kong people have U.K. passports, and [Britain] does not require foreign assets declaration'.⁶⁴ According to recent news reports, the *Rules* have been blamed for the departure of many immigrants and for discouraging others from

⁶⁰ B.C. Premier Glen Clark has said that National Revenue Minister Herb Dhaliwal, who is responsible for implementing the *Rules*, plans to announce changes. See: Chow W., "Foreign assets law will be changed: Clark -- Changes hinted to assets law", The Vancouver Sun, July 24, 1998. A1, A2. This report stated that 'Dhaliwal indicated to Clark that Ottawa might be prepared to raise the reporting threshold of \$100,000 -- an amount opponents say is far too low. There may also be lower penalties for non-compliance, and simplified reporting forms'.

⁶¹ *Ibid.* The changes in the perceptions of foreign investors include their acceptance of the ability to pay principle underlying the Canadian income tax system. For example, a Vancouver entrepreneur said in an interview that '[t]he new tax laws [the foreign reporting rules] are not fair, ... I accumulated assets before I came to Canada, why should I pay tax on that? Over 10 of my friends have already gone back to Hong Kong -- mainly over the [Income Tax Act] changes'. See *supra* note 41. This comment fails to take into account that, according to the *Act*, Canadian residents already have tax imposed on their world-wide income according to their ability to pay, even without the *Rules*. Ironically, even though the comment is not acceptable under the ability to pay principle in the Canadian tax system, it represents quite a few immigrants' attitude toward the tax imposed on their assets outside Canada.

⁶² See *supra* note 60.

⁶³ Chow. W., "Asians flee because of tax, chamber says", The Vancouver Sun, July 24, 1997. D2.

⁶⁴ *Ibid.* This critique was made by David Lee, Hong Kong Bank executive.

coming.⁶⁵ The report, if it is true, fails to provide further statistics to explain that the rapid decline of the number of immigrants coming to Canada is solely due to the passage of the *Rules*. There are other reasons attributable to the departure of immigrants, for example, the B.C. economy downturn and the fear about the handover in Hong Kong being alleviated somewhat, so that some immigrants chose to return to their original countries. However, in some provinces, like B.C. and Ontario, where immigrants have been very influential on the economy, the departure of the investor and entrepreneurial immigrants certainly has an impact on these provinces' economies. While the main goal of the *Rules* is to increase revenue, in the long run, they could turn out to lose revenue instead. A full evaluation of the impact of the *Rules* must take into account the economic activities that foreign investors and entrepreneurial immigrants have contributed to Canada. Even though the *Rules* are only a compliance tool to the *Act* to ensure Canadian residents fairly pay their share of tax on their worldwide income, according to their ability to pay, the measures in it to achieve this goal could be changed to make the *Rules* more acceptable to the new immigrant investors.

2.2.4 The full enforcement of the *Rules* is very difficult

⁶⁵ See *supra* note 60. This report states that 'Vancouver lawyer Mason Loh released confidential federal figures -- obtained through an Access to Information application -- showing that investor and entrepreneurial immigrants from Hong Kong and Taiwan have in the past year [1997] dropped 94 and 78 per cent, respectively. From all countries, the number of investor immigrants fell 38 per cent between 1996 and 1997. Between the first quarter of 1997 and first quarter this year [1998], the decline was 72 per cent. [As for the goal of increasing revenue under the *Rules* and how the investor immigrants affect the tax base, some critics noted that] '[i]f you don't want the rich, you'll get more refugees and family-class immigrants. This will erode the tax base further. It's not doing anything to increase tax revenues'.

The full enforcement of the *Rules* is very difficult. It requires Revenue Canada to hire more people to do all the checks and counterchecks in order to achieve the goal of the *Rules*, preventing Canadian residents from evading tax. An analysis of how cost effective the *Rules* are is warranted.

2.2.5 Simplicity is one of the goals to achieve in a good tax system

Simplicity is one of the goals to achieve in a good tax system.⁶⁶ Simplicity in the tax system is desirable because it is important that taxpayers (individuals and corporations) understand the taxes that they pay and the tax implications of activities they may undertake. All tax measures should, as far as possible, be easy to understand and apply in order to facilitate compliance and enforcement.⁶⁷ Some commentators have noted that 'the reporting forms are horrendously complicated [for both the taxpayers and their accountants] ... Revenue Canada will have to spend millions of money to organize an extremely complex system of checks and counterchecks. And yet, even when those checks are in place, they will not end tax evasion'.⁶⁸ In addition, according to the Special Release in the 1996 Budget, different forms are used for different foreign assets. For example, T1135 for interests in Foreign Property, T1134 for income from foreign

⁶⁶ Simplicity, fairness, economic efficiency, accountability, and predictability are the goals which a good tax system will achieve. Ideally, all the goals should be achieved in the tax system simultaneously. See: Fair Tax Commission, *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission*, (Toronto: University of Toronto Press, 1993) at 44 - 45.

⁶⁷ *Ibid.*

⁶⁸ Yiu G., "Money concerns, not disclosure fears, are sending immigrants home", *The Vancouver Sun*, September, 17, 1997. A19.

affiliates, T1141 for transfers and loans to a foreign trust, and T1142 for distributions from foreign trusts.⁶⁹ Moreover, in each form, there are two or even three parts, and one part can be divided into three, four, or even five sections, in which detailed information is required in response to various questions listed there.⁷⁰ It can be concluded that the reporting forms are too complicated and need to be changed, in order to enhance compliance with the *Rules* and meet the requirement of simplicity in a good tax system.

3. Tax Residence vs. Permanent Residence

⁶⁹ See: Special Release in March 6, 1996 Canadian Federal Budget, referring to (1) An Overview of Information Returns with Respect to Foreign Property, and (2) Information Return Relating to Foreign Affiliates, Information Return Relating to Foreign Property, Information Return in Respect of Transfers to Non-resident Trusts, and Information Return in Respect of Distributions from and Indebtedness Owed to a Non-resident Trust.

⁷⁰ Individuals and corporations resident in Canada will be required to file an annual information return with respect to the following property or transactions:

(1) Interests in Foreign Property (new form T1135) -- persons who own or have an interest in certain types of foreign property must file a return where the total cost of all such property exceeds \$100,000. Both tangible and intangible property must be declared, including shares in a non-resident corporation, interests in a non-resident trust or partnership, and indebtedness owned by a non-resident person. Three important exceptions are made. These are: (a) property used in an active business; (b) property held in RRSPs, RPPs and RRIFs; and (c) personal-use property. Thus, vacation property situated outside Canada does not have to be declared unless, presumably, it also produces rental income.

(2) Interests in Foreign Affiliates (new form T1134)-- the proposed new rules will require substantially more detailed reporting than that already required of Canadian residents who have an interest in a foreign affiliate. The information must cover full details of the capital structure of the foreign affiliate, its financial statements, its assets, income, sales, number of employees, etc. These rules apply whether or not the taxpayer's interest exceeds \$100,000.

(3) Transactions with Offshore Trusts-- disclosure must be made if: (a) a Canadian resident has loaned or transferred property to a non-resident trust, or to a corporation controlled by it (Form 1141); or (b) has received a distribution from such a trust (Form 1142). Certain types of trusts are exempted from this requirement -- essentially those maintained primarily for non-residents and established to administer benefits under retirement or pension funds. The reporting rules are intended to apply to 'five-year immigrant trusts'.

See: Easson A., "Focus on International Tax -- Reporting Offshore Assets", (1996) 6 Canadian Current Tax at 76.

The definition of 'tax resident' has already been elaborated on in chapter II of this thesis, and the definition of 'permanent resident' is in section 2 of the *Immigration Act*.⁷¹ A permanent resident has been defined as a person who has been granted landing and who, once admitted to Canada, can only lose that status under two situations: (1) if a deportation order is made after an immigration inquiry has been held pursuant to subsection 27(1) of the *Immigration Act*, or (2) if that person ceases to be a permanent resident because he/she has left or remained outside Canada with the intention of abandoning Canada as his/her place of permanent residence under section 24 of the *Immigration Act*.⁷² The concept of tax residence under the *Act* and the concept of

⁷¹ Section 2 of the *Immigration Act* says that '[permanent resident] means a person who (a) has been granted landing, (b) has not become [naturalized as] a Canadian citizen, and (c) has not ceased to be a permanent resident pursuant to section 24 or 25.1; and includes a person who has become a Canadian citizen but who has subsequently ceased to be a Canadian citizen under subsection 10(1) of the *Citizenship Act* R.S.C. 1985, c. C-29 (hereinafter referred to as 'Citizenship Act'), without reference to subsection 10(2) of that Act'. ('For the purpose of the *Immigration Act*, a Canadian citizen is defined as anyone who meets the definition of "citizen" under the *Citizenship Act*. Under the latter, a Canadian citizen is a person who was born in Canada, or who was born outside of Canada if, in the case of the latter, one of his or her parents is a Canadian citizen. The term also includes a person who has been naturalized as a citizen'. See: Bagambiire D, *Canadian Immigration and Refugee Law* (Ontario: Canada Law Book Inc., 1996) at 3 - 4.

'The concept [of 'permanent resident'] is new, and would appear to have been invented in 1976, to replace the obsolete term of 'domicile' which was contained in the Immigration Acts starting from the 1910 *Immigration Act*, to the 1952 *Immigration Act*. A permanent resident has the right to come [in] and remain in Canada, and in this respect, enjoys benefits and privileges similar to those of a citizen (subsection 4(1), (2) of the *Immigration Act*). However, this right is not absolute, and [exists] only for as long as the permanent resident has not become a member of that class of permanent resident who may be removed (subsection 27 (1)), and for as long as he or she has not violated a condition imposed at the time of landing. In hierarchical terms, a permanent resident is somewhat between a full citizen and a visitor'. *Ibid*.

⁷² See: Marrocco F.N. & Goslett H.M. ed., *The 1998 Annotated Immigration Act of Canada*, Revised ed. (Toronto: Carswell, 1998) at 162. See also: Waldman L., *Immigration Law and Practice* (Toronto: Butterworths, 1998) (Issue 24, June 1998) at 4.15. See also: section 24 and subsection 27 (1) of the *Immigration Act*. Section 24 states that '[Loss of Status] **[Where person ceases to be permanent resident]** -- (1) A person ceases to be a permanent resident when (a) that person leaves or remains outside Canada with the intention of abandoning Canada as that person's place of permanent residence (b) a removal order has been made against that person and the order is not quashed or its execution is not stayed pursuant to subsection 73(1); (2) *Where residence deemed abandoned* -- Where a permanent resident is outside Canada for more than one hundred and eighty-three days in any one twelve month period, that person shall be deemed to have abandoned Canada as his place of permanent residence unless

permanent residence under the *Immigration Act* are not the same⁷³ but, under some situations, affect each other. For example, it is said that the foreign reporting rules, which are aimed to enhance compliance with the *Act*, drive a lot of wealthy immigrants with foreign assets from Canada to avoid tax. The procedure requires them to declare non-tax residence in Canada. Those immigrants, who have not yet obtained citizenship of Canada, may surrender their right to permanent residency in Canada pursuant to section 24 of the *Immigration Act*⁷⁴, even though they are not required to do so to become non-tax-residents. This is because when section 24 of the *Immigration Act* is applied, these permanent residents of Canada will eventually be deemed to have abandoned their

that person satisfies an information officer or an adjudicator, as the case may be, that he did not intend to abandon Canada as his place of permanent residence.' Subsection 27 (1) refers to the removal order which will deprive a permanent resident of his/her status after admission to Canada. 'A permanent resident can be ordered deported from Canada if he or she falls within one of the removable classes. These removable classes generally deal with persons involved in criminal activity, persons who misrepresented themselves in order to obtain their landing, or persons who failed to comply with the terms and conditions imposed at the time they were granted landing.' As noted, if the person is regarded, by an immigration officer or a peace officer, as a member of an inadmissible class, he/she will be deported from Canada. See: Waldman L., *Immigration Law and Practice* (Toronto: Butterworths, 1998) at 3.3.

⁷³ The intention of an individual is not sufficient in determination of whether he/she is a tax resident. Brian G. Hansen in "Individual Residence" said that '[t]his focusing on the intention of the taxpayer [tax resident] is clearly incorrect ... This is not to say that the taxpayer's intention is disregarded by the court; obviously, if a taxpayer ceases to be resident he will normally intend to leave the country. But the conclusion should be reached by a review of surrounding factors rather than the taxpayer's own wishes'. See: Hansen B.G. "Individual Residence", *Report of the Proceedings of the Twenty-ninth Tax Conference*, 1977 (Toronto: Canadian Tax Foundation, 1978) at 699 - 700. On the contrary, the intention of a permanent resident is very important in determining whether he/she holds or loses his/her status. 'Two fundamental elements essential to create a residence are bodily residence in a place and the intention of remaining in that place. It added that neither bodily presence alone, nor intention alone will suffice. Thus, resident can only be changed by the union of fact and intent'. See: Marrocco F.N. & Goslett H.M. ed., *The 1998 Annotated Immigration Act of Canada*, 1998) at 163. See also: *Min. of Employment & Immigration v. White* (October 22, 1980), 80-1005 (Imm. App. Bd., Montreal).

⁷⁴ See: Chow W. "Foreign-asset reporting remains boondoggle", *The Vancouver Sun*, June 13, 1997. E1, E2. In this report quoted a comment made by Lawyer Mason Loh, who said '[b]efore foreign assets reporting, people would obtain Canadian citizenship before leaving. In the past year, some families have not bothered ... We have handled some families who return their record of landing to the Canadian Commission in Hong Kong, thereby surrendering their right to permanent residency in Canada'. Under these circumstances, it can be concluded that these residents leave Canada with the intention of abandoning Canada as their place of permanent residence. See: subsection 24 (1) of the *Immigration Act*.

residence if they have been absent from Canada in excess of 183 days in any one twelve month period.⁷⁵

It can be concluded that 'resident' in the *Act* is a matter of fact, as the case law has held, and intention is not an essential element in determination of residence⁷⁶. On the contrary, the intention of a 'permanent resident'⁷⁷ is vital in determining whether Canada is his/her place of permanent residence. First, the individual has to choose Canada as his/her place of permanent residence. There are two fundamental elements essential to the creation of a permanent residence; '(1) bodily residence in that place; and (2) the intention of remaining in that place. Neither bodily presence alone or intention alone is sufficient to create a residence'.⁷⁸ Secondly, 'residence can only be changed by the union of fact and intent and in order to accomplish change of residence, there must be intent accompanied by the fact of abode'.⁷⁹ Therefore, if the individual leaves or remains outside of Canada in excess of 183 days in any one twelve month period, the individual has to possess a valid returning

⁷⁵ See: subsection 24 (2) of the *Immigration Act*.

⁷⁶ See: chapter II (2.2.2) of this thesis referring to residence.

⁷⁷ The intention alone is not enough to prove that an individual takes Canada as his/her place of permanent residence; it needs to be complemented by some objective facts. In *Nakhjavani v. Canada (Secretary of State)* (1987), 2 Imm. L.R. (2d) 241 at p. 245 (Fed. T.D.) stated: 'A self-serving declaration of intention therefore might have little weight unless it were buttressed by objective facts representing tangible expressions of that intention, i.e., ownership of residential property, car registration, bank accounts, club or association memberships, and particularly, the continuing presence in Canada of immediate family members and to whom an individual might return from time to time even for only brief periods of time.' See: Waldman L., *Immigration Law and Practice* (Toronto: Butterworths, 1998) at 4.20.

⁷⁸ See: Marrocco F.N. & Goslett H.M. ed., *The 1998 Annotated Immigration Act of Canada*, Revised ed. (Toronto: Carswell, 1998) at 164.

⁷⁹ *Ibid.* See also: section 24 of the *Immigration Act*.

resident permit⁸⁰ to prove that he/she has no *intention* of abandoning Canada as his/her place of permanence home. Otherwise, the individual will be very likely to lose his/her permanent resident status.⁸¹

3.1 Losing Permanent Resident Status Also Means Losing Canadian Citizenship?

⁸⁰ 'The requirements for obtaining a returning resident permit are set out in section 26 of the *Immigration Regulations*. There are grounds for issuance where the Immigration Officer is satisfied that the person intends to leave, or has left, Canada: (1) for the purpose of carrying out responsibilities as a representative or employee of a corporation or business organization established in Canada, or as a representative or employee of the Government of Canada or of a province or a municipality in Canada; (2) for the purposes of upgrading professional, academic, or vocational qualifications; (3) for the purpose of accompanying a member of his or her family who is a Canadian citizen or has been issued a returning resident permit. This provision can generally be used to the benefit of those who are accompanying family members abroad. The applications may be submitted simultaneously; or (4) in any circumstances not referred to above that an officer considers appropriate. The final ground is discretionary and would cover most compelling circumstances, such as a death or illness in the family, the need for medical treatment abroad, and the winding up of business or personal affairs.' See: Berezowski N.M. & Trister B.J., (Canada Practice Guide Immigration) *Citizenship* (Toronto: Carswell, 1996) at 50. In applicable instances, to obtain a returning resident permit will not only help to counter any presumption that a person has abandoned his/her permanent resident status, but will serve as a primary indicia of the person's intention to maintain his/her residency in Canada for purposes of the residency requirement. *Ibid.* at 50 - 51.

⁸¹ See: subsection 24 (2) and section 25 of the *Immigration Act*. However, '[s]ubsection 24 (2) of the *Immigration Act* does provide some protection to permanent residents who do not wish to lose their status in Canada but who will because of an absence of more than 183 days in a 365-day period be deemed to have abandoned Canada and hence would be found to have lost their permanent resident status. That section allows a person to apply for a returning resident's permit. A person in possession of such a permit is not deemed to have abandoned Canada even if outside Canada for more than 183 days in a 365-day period if he or she returns to Canada prior to the expiry of the returning resident's permit. However, even if a person is in possession of such a permit, he or she is not guaranteed readmission to Canada as a permanent resident. This is at the discretion of the immigration officer at the port of entry who can, despite the returning resident's permit, still make a report pursuant to s. 20 (1) of the *Immigration Act*'. (The report pursuant to section 20 (1) of the *Immigration Act* refers to the situations where an immigration officer is of the opinion that it would or may be contrary to the *Immigration Act* or the regulations to grant admission to a person examined by the officer or otherwise let that person come into Canada. A removal order will then be made against the person as a result of a report made pursuant to subsection 20 (1)(a). The removal order against that person may be made on the basis that that person is a member of any inadmissible class. Therefore, that person is not qualified to be a permanent resident of Canada.) See: Waldman L., *Immigration Law and Practice* (Toronto: Butterworths, 1998) at 4.15. See also: subsection 20 (1) and section 21 of the *Immigration Act*.

A series of steps must be followed to obtain Canadian citizenship (hereinafter referred to as Citizenship), pursuant to subsection 5(1) of the *Citizenship Act*, R.S.C. 1985, c. C-29 (hereinafter referred to as the *Citizenship Act*). First, an adult applicant from a foreign country must apply for permanent residency in Canada. Then, he/she has to land in Canada within a limited period of time after his/her application has been accepted. After the individual has been lawfully admitted to Canada for permanent residence, he/she must have not ceased to be a permanent resident under section 24 of the *Immigration Act*, and must have, within the four years immediately preceding the date of his/her application for Citizenship, accumulated at least three years of residency in Canada.

By failing to reside in Canada for at least 183 days in any one twelve month period, a permanent resident is at risk of losing his/her status under section 24 of the *Immigration Act*.⁸² This is a big concern for immigrants who want to obtain Canadian citizenship.

⁸² However, according to the 1978 landmark decision of Mr. Justice Thurlow in *Re Papadogiorgakis*, [1978] 2 F.C. 208 (Fed. T.D.), if the applicant can establish that he or she has centralized his or her mode of living in Canada, then *temporary absences* will not necessarily mean that the applicant's residency during these absence ceases to be in Canada. In this case, Mr. Justice Thurlow states that: '[a] person with an established home of his own in which he lives does not cease to be resident there when he leaves it for a temporary purpose whether on business or vacation or even to pursue a course of study.' See *supra* note 80 at 54. 'Since the "Thurlow" decision, the liberal interpretation has been applied and even strengthened. The amendment to the *Citizenship Act* [S.C. 1974-75-76, c. 108.] respecting the loss of permanent residence under s. 24 of the *Immigration Act* [R.S.C. 1985, c. I-2.] has been used to support the "Thurlow" approach. ... The reasoning is well summarized by Martin J. in *Re Lee* (20 Dec. 1988), Action No. 1135 T-2713-87 (Fed. T.D.) ... Under s. 24(1) of the *Immigration Act*, 1976, as amended, the loss or retention of a person's status as a permanent resident depends on his intention in respect of such residence when he leaves or remains outside of Canada. It is particularly applicable to the student who leaves only to attend a school of learning with full intention of returning to Canada during school vacations and on termination of his education there. It also covers the employee who is sent by his Canadian employer on company business to another country to perform temporary services and at the termination thereof intends to return. The determination as to whether the applicant has the required intention to retain his permanent residence in Canada is not left entirely to the applicant because of the presumption established by s. 24(2) that he has abandoned the same if he remains outside the country for more than 183 days in any 12-month period. Such inference maybe rebutted by him if he satisfies an investigation officer or an adjudicator as the case may be that he did not intend to abandon Canada as his place of permanent residence.' See: Waldman L., *Immigration Law and Practice* (Toronto: Butterworths, 1998) at 4.17.

Most immigrants are potential citizenship applicants. 'The acquisition of Canadian citizenship is and will be for most immigrants the end product of a long term process commencing with the application for permanent residence in Canada'.⁸³ The *Citizenship Act* provides in paragraph 3(1)(c) that a person is a citizen if the person has been granted or has acquired the right to citizenship pursuant to paragraph 5(1)(c) of the *Citizenship Act*.⁸⁴ Paragraph 5(1)(c) of the *Citizenship Act* sets out the residency requirement for

In some circumstances, the Governor-in-Council may direct the Minister to grant citizenship to any person pursuant to subsection 5(4) of the *Citizenship Act*, the waiver of Residency Requirement provision. Subsection 5(4) states that the waiver provision may be applied (1) to alleviate special and unusual hardship, (For example, in *Re Chan* (1992), 18 Imm L.R. (2d) 300 (Fed. T.D.), although the applicant did not meet the residency requirement, she had acquired property in Canada, and her husband and children had been granted Canadian citizenship. The court recommended that the residency requirement be waived.); or (2) to reward services of exceptional value to Canada. (This subsection has most often been used to expedite the granting of citizenship to athletes. For example, in *Re Mady* (October 19, 1978), Doc. T2496-78 (Fed. T.D.), the applicant, who was a swimmer and Olympic gold medalist contender, was granted citizenship after approximately two years residence in Canada. The Citizenship Judge had decided against recommending the exercise of discretion by the Governor-in Council pursuant to subsection 5(4), but the Federal Court chose to make a favourable recommendation.) See *supra* note 80 at 59 - 60.

⁸³ Hoppe, Calvin Carter, "Canadian Citizenship: A New Beginning But An End In Itself -- Strategies For The Immigration/Citizenship Lawyer", in *Canadian Immigration Law & Policy II* (Canadian Bar Association, May 1991) at 6.

⁸⁴ Paragraph 3(1)(c) of the *Citizenship Act* says that '[s]ubject to this Act, a person is a citizen if ... (c) the person has been granted or acquired citizenship pursuant to section 5 [regarding permanent residents' application for citizenship] or 11 [regarding the resumption of citizenship] and, in the case of a person who is fourteen years of age or over on the day that he is granted citizenship, he has taken the oath of citizenship'. Paragraph 5(1)(c) of the *Citizenship Act* says that '[t]he Minister shall grant citizenship to any person who has been lawfully admitted to Canada for permanent residence, has not ceased since such admission to be a permanent resident pursuant to section 24 of the *Immigration Act*, and has, within the four years immediately preceding the date of his application, accumulated at least three years of residence in Canada calculated in the following manner: (i) for every day during which the person was resident in Canada before his lawful admission to Canada for permanent residence the person shall be deemed to have accumulated one-half of a day of residence, and (ii) for every day during which the person was resident in Canada after his lawful admission to Canada for permanent residence the person shall be deemed to have accumulated one day of residence. See: *Citizenship Act* S.C. 1974-75-76, c. 108. A question may arise: what is a 'Day' in the calculation of a day of residence in which part of that day was spent in Canada but part of that day was spent outside Canada (i.e. the date of departure or the date of arrival) ? The language in both subparagraphs of paragraph 5 (1)(c) is 'every day during which'. Thus, Carter Calvin Hoppe says that, in his practice, he advised clients that everyday in which even part of the day was spent in Canada would count as a day of residence. See *supra* note 83 at 8. See also *supra* note 80 at 52.

naturalization⁸⁵ and suggests that, to be granted Canadian citizenship, an applicant must meet a three-fold test, which includes: (1) have been lawfully admitted to Canada for permanent residence; (2) have not ceased since such admission to be a permanent resident pursuant to section 24 of the *Immigration Act*; and (3) have, within the 4 years immediately preceding the date of the application, accumulated at least 3 years of residence in Canada.⁸⁶

Some Taiwanese immigrants have problems meeting the residency requirement and are at risk of losing their permanent resident status. This is their big concern, as losing permanent resident status will consequently affect their application for Canadian citizenship.⁸⁷ Even though the Taiwanese immigrants to Canada do appreciate the clean air and water, democracy, and social welfare in Canada, the business investors, especially, are deterred by the high tax rates in Canada. It is said that 'the effort to attract investors is an international competition waged on many levels by many countries. In this game, [Canada] has two huge handicaps: the twin perceptions that our regulatory regimes are

⁸⁵ 'Naturalization' is the process by which a person acquires nationality after birth and becomes entitled to the privileges of a state's citizenship. See: *Black Law's Dictionary*, 6th ed. by Black H.C. (St. Paul, Minn. : West Publishing Co., 1990) at 1026. In Canada, individual naturalization must follow certain steps, and the Minister shall grant citizenship to any person, an adult applicant, (as contrary to minor applicants), who (1) makes application for citizenship; (2) is eighteen years of age or over; (3) has been lawfully admitted to Canada for permanent residence and has complied with section 24 of the *Immigration Act* not ceasing to be a permanent resident and not under a removal order against him/her; (4) has accumulated at least three years of residency, within the four years immediately preceding the date of his/her application; (5) has an adequate knowledge of one of the official languages of Canada; (6) has an adequate knowledge of Canada and of the responsibilities and privileges of citizenship; and (7) is not under a deportation order and is not the subject of a declaration by the Governor in Council made pursuant to section 20 of the *Citizenship Act*. See: subsection (5)(1) of the *Citizenship Act*.

⁸⁶ See: Waldman L., *Immigration Law and Practice* (Toronto: Butterworths, 1998) at 4.14.

⁸⁷ See: paragraph 5(1)(c) of the *Citizenship Act*.

unfriendly to business and that our taxation system is, in a word, punitive'.⁸⁸ '[Asian immigrants] seem to have a curious and un-Canadian desire to keep the money they earn. And, when it comes to attracting potential investors, our 54 per cent marginal tax rate doesn't compete with the United States' 30 per cent and Hong Kong's 15 per cent'.⁸⁹ This is why it is a dilemma for the potential Asian immigrants to decide 'to go or not to go', and, for those who have already come to Canada, 'to stay or not to stay'.

There are a number of reasons why some immigrants may encounter difficulties in complying with the residency requirement, which include the following⁹⁰:

- (1) quite often, it is necessary that an individual depart Canada shortly after landing to settle his or her affairs. It would be foolish for an intending immigrant to dispose of business or other property prior to issuance of an immigration visa; faced with a short time period in which to land, it may therefore be necessary to return to the country of origin temporarily for such purposes;
- (2) ongoing absences from Canada necessitated by continued business obligations abroad may result in frequent trips from Canada;
- (3) transfer out of Canada for employment purposes;
- (4) continuance or commencement of studies abroad;
- (5) illness or other emergencies requiring attendance outside of Canada.

With a view to analyzing the tax consequences to some immigrants who have difficulty in complying with the residency requirement, the discussion of their absence from Canada will only focus on the reasons for business and employment purposes.⁹¹

⁸⁸ Lambert G., "So Long To Our Wealthy Asian Immigrants", The Vancouver Sun, July, 28, 1998. A11. (Garrett Lambert is a consultant and a professor of business at the University of Victoria. He was Canadian high commissioner to Hong Kong (1994-97), Malaysia (1998-90) and Nigeria and Sierra Leone (1982-85).

⁸⁹ *Ibid.*

⁹⁰ See *supra* note 80 at 48.

(1) Business purposes

Unsatisfied with the less favourable investment environment in Canada, i.e. 'the slow pace of business, a shortage of jobs, high taxes, a sluggish economy'⁹², many successful business class immigrants continue doing or extending business outside Canada. Under these circumstances, due to the lengthy and constant absences from Canada, they often have problems meeting the residency requirement and thus, are at risk of losing their permanent resident status. Furthermore, it also affects their application for Canadian citizenship.⁹³ For example: in *Re Law* (1992)⁹⁴ Pinard J. said that 'the Court could not conclude that the applicant had the requisite intention [of maintenance of residence in Canada] as he did not have a business in Canada, did not make a contribution to Canada

⁹¹ The other two reasons regarding (1) the continuance or commencement of studies abroad; and (2) illness or other emergencies requiring attendance outside of Canada, have little weight in the discussion of tax consequences.

⁹² See: Baines D., "Impact of law on immigrants hard to assess", *The Vancouver Sun*, October 3, 1997. A2.

⁹³ For (1) the losing of permanent resident status, see: section 24 of the *Immigration Act*, (2) the residency requirement, see: paragraph 5(1)(c) of the *Citizenship Act*.

⁹⁴ See: *Re Law* (22 May 1992) Action No. T-1604-91 (Fed. T.D.). In this case, 'the applicant's family were well established in Canada but he had been physically present in Canada for only 136 days during the relevant time period and these were accumulated through a series of short stays, most lasting no longer than 2 weeks. The appellant's lengthy absences from Canada were necessary to enable him to supervise his business interests. Pinard J. agreed with the citizenship court judge that the residency requirement had not been met because the applicant only visited Canada for short periods of time for purely personal reasons, and had not made Canada the place where he "regularly, normally or customarily" lives'. See: *supra* note 86 at 4.26. Another similar case, see: *Re Lau* (6 Feb. 1992), Action No. T-136-91 (Fed. T.D.). In *Re Lau*, 'the applicant was a successful Hong Kong businessman who arrived in Canada with his family in 1983. His business kept him very active in Hong Kong and traveling all over the world. During the 4 year period in question, that is, between November 10, 1985 and November 10, 1989, he had come to Canada on only 7 occasions and never more than 20 days at a time. Dube J. found that the residency requirement had not been met'. *Ibid.*

as a landed immigrant, and visited only for short periods of time, although he had purchased a home in Canada in which his wife and children lived'.⁹⁵

(2) Employment

For some permanent residents, it is the lack of good job opportunities in Canada that drives them outside Canada to make a living. Therefore, they are not able to meet the residency requirement. This is especially true in circumstances where they have worked hard to achieve their professional and career qualifications and the commensurate income in their native countries. However, after coming into Canada, a completely new environment, the same levels of job satisfaction and income can hardly ever be achieved.⁹⁶ In short, the reality is driving these permanent residents outside Canada. Thus, these permanent residents are also at risk of losing their status and their application for citizenship will be affected, since they are working outside Canada for a non-Canadian employer by their own decision, instead of being sent by a Canadian employer on company business to another country to perform temporary services, as said by Thurlow A.C.J., in *Re Papadogiorgikis* (1978).⁹⁷ It can be concluded that the time spent outside of Canada

⁹⁵ See *supra* note 80 at 57.

⁹⁶ See *supra* note 68.

⁹⁷ *Re Papadogiorgikis* (1978), 88 D.L.R. (3d) 243, [1978] 2 F.C. 208. In a more recent case, *Re Ferreira* (5 June 1992) Action No. T-2080-91 (Fed. T.D.), 'the applicant and his family came to Canada as permanent residents on November 25, 1987. However, he agreed with his employer to spend the next 2 years overseeing the company's operations in Hong Kong on the condition that he would then be given a position in Canada. He was in Hong Kong for 5 to 10 weeks at a time and stayed in the apartment of relatives. MacKay J. found that the residence requirement had been met'. See *supra* note 86 at 4.24.

may be included in the calculation of the 3-year residency requirement, but only under certain circumstances.⁹⁸

However, due to the inconsistency of the case laws⁹⁹, it is incorrect to say that, due to failure to meet the residency requirement, a permanent resident will definitely lose his/her status or citizenship. It can be fairly concluded that each case will stand and be judged on its own facts. In *Re Calderwood* (1988)¹⁰⁰ Joyal J. stated:

⁹⁸ '(1) The person first establishes a residence in Canada by centralizing his or her mode of living in Canada. This may occur prior to the 4-year period. (2) The person intends to maintain that residence during the time spent outside of Canada. Factors which may be taken into consideration in establishing this intention include previous requests for citizenship, requests for returning resident visas, requests to employer for transfers back, etc. (3) the person takes steps to maintain that residence even while outside of Canada. Factors which may be taken into account include: (a) Presence of family in Canada; (b) A continuing place of residence in Canada; (c) Return trips to Canada; (d) Filing of income tax returns in Canada; (e) Ownership of residential property in Canada; (f) Car registration in Canada; (g) Provincial driver's licence; (h) Bank accounts; (i) RRSPs; (j) Club of association memberships (community or professional); (k) Payroll deductions for income tax, C.P.P., etc.; (l) O.H.I.P. (provincial health insurance) Membership'. *Ibid.* at 4.6 - 4.7.

⁹⁹ For example, in *Re Lee* (12 Nov. 1991), Action No. T-270-91 (Fed. T.D.), even though the applicant failed to meet the residency requirement for business reasons, the court held that he is still regarded as having met the requirement. 'The applicant arrived in Canada and became a permanent resident on February 27, 1981. At the time of his citizenship application, he was 316 days short of the required 1,095 days of actually being physically present in Canada. Cullen J. took into account that the applicant was an importer/exporter who had come to Canada under the entrepreneur programme, and that absences from Canada were part of his business. He found that the residency requirement has been met'. See *supra* note 86 at 4.25. With respect to the residency requirement, it is said that '[t]he current practice is to give applicants a three month grace period. That is, the applications of those who have between 1005 and 1095 days of physical presence in Canada in this four year period will be treated as if they have 1095 days physical presence in Canada, and will be treated as having satisfied the residency requirement at first instance. [However,] should an applicant have fewer than 1005 days physical presence in Canada in the four year period preceding the application for Citizenship, he or she is not necessarily precluded from satisfying the residency requirement. ... [For example,] in *Re Aviles* (1994), 89 F.T.R. 76 (Fed.T.D.), although the applicant, his spouse and their children had only accumulated 545 days of physical presence in Canada, because the applicant's employment obligations with his Canadian employer necessitated his absences from Canada, Rothstein J. was satisfied that the requisite intention to come to and remain in Canada had been met'. See *supra* note 80 at 51,56.

¹⁰⁰ *Re Calderwood* (1988), 21 F.T.R. 105 at 107.

'An analysis of the *Papadogiorgakis* decision discloses the numerous avenues of enquiries which may be followed in order to establish if residency rules under the *Citizenship Act* have or have not been met. Various indicia have accordingly been applied in individual cases. Such indicia as family connections in Canada, a continuing place of residence, bank accounts in Canadian banks, provincial driving licences, membership in OHIP or in community and professional organizations, frequency of return trips to Canada, have been applied. The list may be said to be inexhaustible and the weight to be given to any of its several manifestations may of course vary from case to case.

As a result, the conclusion which may be drawn by the application of all such surrounding circumstances will not often meet that degree of mathematical precision which a simple day-count would provide. It is a fact-finding situation with its usual inferences, implications or conclusions on which judgment calls may well be different'.¹⁰¹

3.2 Losing Permanent Resident Status, But Still Having To Pay Tax?

As indicated above, some wealthy immigrants choose to surrender their right to permanent residency to Canada in order to avoid tax. The procedure requires them to declare non-tax residence in Canada. This is especially crucial when the five-year tax exemption (tax holiday) for new immigrants is approaching an end. 'An immigration trust is useful to shelter income and capital gains for the first five years of a new immigrant's stay in Canada'.¹⁰² As a general rule, Canadian residents are taxable on their worldwide income (including capital gains) on an annual basis¹⁰³, but, under subsection 94(1) of the *Act*, new immigrants to Canada, with a very careful and appropriate tax planning, are

¹⁰¹ See *supra* note 86 at 4.21.

¹⁰² Krishna V., "Offshore Trusts" (1998) 8 Canadian Current Tax. (1998 CCT LEXIS 1; (1997-1998) 8 Canadian Current Tax 41.)

¹⁰³ See: subsection 2(1) of the *Act*.

entitled to a five-year tax holiday upon arrival in Canada. A new immigrant can set up an offshore trust¹⁰⁴ in a tax haven and name his/her family as beneficiaries¹⁰⁵. The Canadian resident beneficiaries of a non-resident family trust do not have to pay any tax on the trust's offshore income (including offshore capital gains) for five years. This type of trust allows the immigrant to defer his/her taxes on offshore income and gains for five years¹⁰⁶. Nevertheless, an offshore trust may become subject to Canadian tax, pursuant to the Canadian foreign accrual property income (FAPI) rules set out in section 94 of the *Act*, if the trust or a foreign corporation controlled by the trust, acquires property from a beneficiary or from a person related to the beneficiary (a 'contributor') who was resident in Canada at any time in the 18 months¹⁰⁷ before the end of the trust's taxation year and

¹⁰⁴ 'A foreign immigration trust may be set up before or after an immigrant becomes a Canadian resident. Usually, an immigrant establishes a foreign trust before he becomes a resident of Canada for the following reasons: (1) to fully use the five-year tax exemption period; and (2) to avoid the disclosure requirements. Under paragraph 69(1)(b), when a person transfers or gifts assets to a trust, he is deemed to receive the proceeds of the disposition equal to its fair market value. When an immigrant becomes a resident of Canada, the cost base of his assets (other than taxable Canadian property) is stepped up to fair market value and there is usually no gain or loss on the transferring of assets to a trust. However, under subsection 150 (1), he may have an obligation to disclose the disposition of capital property. If his income tax return is audited, Revenue Canada may become aware of the foreign trust'. See: Ngan S., "Personal Tax Planning-- Foreign Trust Structures For Immigrants" (1990) 38 Canadian Tax Journal 1264 at 1266.

¹⁰⁵ See *supra* note 102. For the definition of 'beneficiary', see: subsection 248 (13) of the *Act*.

¹⁰⁶ See *supra* note 102.

¹⁰⁷ 'Tax planning is essential, exceeding the five-year mark by even one day can in some cases result in a Canadian tax liability for up to 18 months. ... The 18-month requirement is relevant to immigrants who leave Canada after their trusts become subject to subsection 94(1), because that provision limits the trust's period of taxation to a maximum of 18 months beyond the time at which the immigrant ceases to be a Canadian resident. This period of extended taxation, however, can be limited to 6 months if the immigrant leaves Canada before July of the year in which he or she intends to leave. For example, if an immigrant has been resident in Canada for 60 months on October 1, 1993 and remains in Canada until July 2, 1994, the immigrant's offshore trust will be subject to subsection 94(1) for all of 1993, 1994, and 1995. The trust will be taxable in 1995 because the immigrant will have been resident in Canada in the 18-month period before the end of 1995 (that is, he or she was resident on July 2, 1994). If, however, the immigrant departs on June 30, 1994 rather than July 2, 1994, the trust will be taxable only for the 6 months after the immigrant departs -- namely, July through December 1994'. See: Day M., "International Tax Planning -- Offshore Trust Planning: The Fifth Year And Beyond" (1993) 41 Canadian Tax Journal 979 at 990, 999.

had been resident in Canada for a combined period of five years.¹⁰⁸ That is why many wealthy immigrants who choose to declare non-residence and depart from Canada will do so before the end of the five-year tax exemption period, in order to avoid tax.

Theoretically, the individual, who has not yet obtained citizenship in Canada, is not required to surrender his/her right to permanent residency to become a non-tax-resident, because the resident concept in the *Act* and that in the *Immigration Act* are different. However, since the individual wants to become a non resident for tax reasons, he/she can not stay in Canada for more than 183 days, or he/she will be caught by subsection 250(1) of the *Act* and deemed to be a tax resident and thus have to pay income tax on his/her worldwide income. Generally speaking, failure to live in Canada for more than 183 days without satisfactory reasons by a permanent resident will cause him/her to lose his/her status under section 24 of the *Immigration Act*. A permanent resident, before he/she obtains his/her Citizenship, is not required to surrender his/her right to permanent residency to become a non-tax-resident from the perspective of the *Act*. However if, in order to avoid tax, a permanent resident fails to live in Canada for at least 183 days in any one twelve month period without satisfactory reasons, he/she is very likely to lose his/her status under section 24 of the *Immigration Act*, and consequently, lose his/her opportunity to apply for Citizenship because he/she disrupts the Citizenship application procedure prescribed in the *Citizenship Act*. For practical purposes, a permanent resident, who

¹⁰⁸ See *supra* note 104 at 1264 - 1265. 'After the initial five year period, a foreign immigration trust is deemed to be a Canadian resident, and its taxable income earned in Canada, its Foreign Accrual Property Income (FAPI), and its share of the FAPI of any controlled foreign affiliate (CFA) become taxable in Canada'. *Ibid.*

wants to declare non residence for tax reasons, surrenders his/her right to permanent residency in Canada. Thus, if a permanent resident, before he/she obtains Citizenship, declares non-residence for tax purposes and disrupts the procedure of the Citizenship application, he/she in reality loses both his/her permanent resident status and opportunity for citizenship.

However, for those immigrants who abandoned or lost their permanent resident status, it does not mean that they are free from Canadian tax thereon. Any individual who gave up his/her permanent resident status and declared non-residence, is still subject to Canadian income tax but only on amounts earned or produced from employment in Canada, business in Canada or dispositions of taxable Canadian property, under subsection 2(3) of the *Act*. In addition, the individual is also liable to Part III tax on interest, dividends, etc. in the *Act*. This has been illustrated in chapter II of this thesis.

4. Conclusion

The *Rules* highlight the dilemma of Taiwanese immigrants, which is whether to stay in Canada to keep their right to permanent residency, or to leave to avoid Canada's high tax rates and the double taxation problem between Canada and Taiwan. As I have demonstrated the *Rules* have created tremendous controversy and prompted Finance Minister Paul Martin to repeatedly delay implementation. The *Rules* are aimed to prevent Canadian residents from evading tax. However, in my view, the Rules are not a cure all

for tax evasion. Under the principle of fairness, the tax system must ensure a fair distribution of the tax burden among taxpayers. More importantly, a fair tax system is used to reflect the taxpayers' ability to pay. Nevertheless, taxation is not only about generating revenue, it is also a matter of economic efficiency and fairness. The *Rules* are criticized as a violation of privacy, a forerunner of a wealth tax, unfairly targeting wealthy Canadians and driving wealthy immigrants away, discouraging foreign investors, and being too complicated. While the main goal of the *Rules* is to increase revenue, without a full evaluation of the impact of the *Rules*, in the long run, they could turn out to lose revenue instead. In this chapter, it is suggested that some changes are needed to make the *Rules* more acceptable.

The concept of tax residence under the *Act* and the concept of permanent residence under the *Immigration Act* are not the same, but under some situations, affect each other. The intertwined concepts of tax residence in the *Act*, permanent residence in the *Immigration Act*, and their relations to obtaining/losing Canadian citizenship can be analyzed as follows. A permanent resident, before he/she obtains his/her citizenship, is not required to surrender his/her right to permanent residency to become a non-tax-resident from the *Act*'s perspective. However if, in order to avoid tax, a permanent resident fails to live in Canada for at least 183 days in any one twelve month period without satisfactory reasons, he/she is very likely to lose his/her status under section 24 of the *Immigration Act*, and consequently, lose his/her opportunity to apply for Canadian citizenship because he/she disrupts the citizenship application procedure prescribed in the *Citizenship Act*.

For practical purposes, a permanent resident, who wants to declare non residence for tax reasons, surrenders his/her right to permanent residency in Canada. Therefore, as far as the related provisions (in the *Act*, the *Immigration Act*, and the *Citizenship Act*) are concerned, if a permanent resident, before he/she obtains Citizenship, declares non-residence for tax purposes and disrupts the procedure of the citizenship application, he/she in reality loses both his/her permanent resident status and opportunity for citizenship.

For those immigrants who choose to lose their permanent resident status for tax reasons, they are not therefore free from Canadian tax. Any individual who gave up his/her permanent resident status and declared non-residence, is still subject to Canadian income tax but only on amounts earned or produced from employment in Canada, business in Canada or dispositions of taxable Canadian property, under subsection 2(3) of the *Act*. In addition, the individual is also liable to Part III tax on interest, dividends, etc. in the *Act*, as illustrated in chapter two.

Chapter IV

A TREATY BETWEEN CANADA AND TAIWAN IS NEEDED

A PRECEDENT: AUSTRALIA-TAIWAN TREATY

1. Introduction

This chapter addresses the potential of having a treaty (or an agreement) between Canada and Taiwan to avoid double taxation. The possibility of having a tax agreement between Canada and Taiwan to avoid double taxation has been the concern of many Canadians as well as Taiwanese, particularly those who are involved in business and/or for immigration reasons. Their concerns and some related issues have been discussed in chapters two and three of this thesis.

On May 29, 1996, Australia signed a unique tax agreement with Taiwan concerning the avoidance of the double taxation problem and the prevention of tax evasion. New Zealand and Vietnam have signed tax agreements with Taiwan as well. In light of this trend, theoretical and practical grounds for the development of a hypothetical treaty between Canada and Taiwan will be provided. Based on the economic, cultural, and trading ties between Canada and Taiwan, having a treaty may facilitate their bilateral relations. This chapter will address various ways in which the problem of double taxation by Canada and Taiwan may be solved by a treaty.

This chapter starts with the general discussion of treaties, then outlines the benefits of a tax treaty for the individual who pays tax in both jurisdictions. A related issue, the function and purpose of the 'tie-breaker rules' will also be addressed. Discussions will focus on the Australia-Taiwan Tax Agreement and explain why it can be viewed as a precedent for a potential tax agreement between Canada and Taiwan. Finally, three model treaties, namely, the OECD, the U.N., and the U.S. Models, will be analyzed in order to add to the discussion of the potential tax agreement between Canada and Taiwan some generally accepted rationales that underlie the model treaties.

2. Treaty

2.1 General Discussion of Treaties

'Treaty is the generic term used to embrace convention, agreement, arrangement, protocol, and exchange of notes. International law does not distinguish between agreements identified as treaties and other agreements. For the purposes of the 1969 Vienna Convention on the Law of Treaties U.K.T.S. 58 (1980) Cmnd. 7964; 8 I.L.M. 679 (1969); 63 A.J.I.L. 875 (1969), "treaty" means an international agreement concluded between States in written form and governed by international law. The Convention, [which] is regarded as essentially codifying customary international law, concerns itself only with written agreements. [Nevertheless, one commentator has noted that] even

though treaties invariably are in written form, it cannot be stated unequivocally, however, that an oral agreement has no legal significance. Oral statements have been held to be binding'.¹

A treaty is one method of solving the double taxation problem. To avoid double tax levied by Canada and Taiwan on Taiwanese immigrants to or investors in Canada, and vice versa, a treaty might be the most effective mechanism. However, '[b]ecause a treaty is an agreement which is binding in international law, a treaty can only be made by an entity having international legal personality'.² A self-governing entity in domestic affairs does not necessarily have international personality to enter into treaties. For example, '[i]n 1867 the various colonies of the British Empire, although many of them (including those of British North America) were self-governing in domestic affairs, lacked the capacities to enter into treaties'.³ Taiwan is not internationally recognized as a nation state. Instead, it is generally recognized as a province of China. Canada is internationally recognized as a nation state. The possibility of having a treaty between Canada and Taiwan to facilitate the substantial relations, in terms of the trading, historical and cultural connections between the two jurisdictions, is discussed in the context of the political

¹ Wallace R. M.M., *International Law*, 2nd ed. (London: Sweet & Maxwell, 1992) at 219 - 220.

² Hogg P. W., *Constitutional Law of Canada*, vol. 1, 3rd ed. (Toronto: Carswell, 1992) at 11-2.

³ *Ibid.* In this regard, '[t]he Empire spoke with one voice, and the voice was that of the imperial government in Great Britain. The common law accorded to the Crown (the exclusive branch of government in Great Britain) full power to conduct foreign affairs, including the making of treaties, for the entire Empire. ... As the Empire became the Commonwealth, and as its members acquired international personality in their own right, the treaty-making powers of the British government were gradually distributed to the independent members of the Commonwealth'.

dilemma of how can a nation state enter into a treaty with a jurisdiction that is not internationally recognized as a nation state. Some additional issues include the question of, even if the signing of a tax treaty between Canada and Taiwan is possible, what model treaty would the hypothetical treaty follow, and why? How would Canada and Taiwan negotiate to get their tax benefits? A related issue, how Canada can possibly bring the hypothetical treaty into effect, will also be discussed.

2.2 Benefits of Tax Treaties

As explained in chapter one, this thesis will only focus on discussion of individual income tax. With respect to individual tax, the benefits of tax treaties are that by employing the 'tie-breaker rules'⁴ only one of the contracting states has the authority to tax an individual on the same income. Double taxation thus can be avoided. Specifically speaking, through application of the 'tie-breaker rules', the conflict of different connecting factors, used to determine the connections of an individual to the contracting states in a treaty, can be resolved. Therefore, a treaty is generally regarded as the most efficient mechanism to solve the double taxation problem.

2.3 Tie-breaker Rules to Determine Residency

⁴ For the definition and function of the 'tie-breaker rules', see: section 2.3 of this chapter.

Residency and the 'tie-breaker rules' are separate issues, but are related to each other. For the purpose of avoiding double taxation, a treaty is used to determine which state has the authority to tax an individual. The mechanism, however, is the utilization of the tie-breaker rules to determine an individual's residency. The residence issue has been discussed in chapter two of this thesis. Tie-breaker rules are used in a treaty to determine which state has the authority to tax an individual, according to his/her residence connection with that state, and, double taxation can be avoided. The question of whether a person is a resident of a state for tax purposes is to be determined by the domestic laws of that state.⁵ The 'residence' article is one of the most important provisions in a tax treaty, as it determines who can claim the benefit of a treaty. It also affects the operation of other articles in a treaty which allocate income according to the residence of the taxpayer. For example, 'business profit can be taxed only by the state of the taxpayer's residence (except for the profit of a permanent establishment), and reduced withholding tax rates only apply to residents of the other treaty country'.⁶

The importance and various functions of the concept of residence are recognized in three cases:

- (a) in determining a convention's personal scope of application;
- (b) in solving cases where double taxation arises in consequence of double residence;
- (c) in solving cases where double taxation arises as a consequence of taxation in the

⁵ Krishna V. et al., *Canada's Tax Treaties I*, (Toronto and Vancouver: Butterworths, 1981, 1981-1997), at 1632, 2054. See also: IFA International Fiscal Association Canadian Branch, *Special Seminar on Analysis of Canada's Tax Conventions and Comparison to the OECD Model Double Taxation Convention* (Toronto: Richard De Boo Limited, 1979) at 49 - 54.

⁶ Krishna V. et al., *Canada's Tax Treaties I* (Toronto and Vancouver: Butterworths, 1981, 1981-1997), at 1632, 2054.

State of residence and in the State of source or situs.⁷

The contracting states could impose tax upon individuals based on similar criteria which happen to be satisfied in respect of a particular individual for both states. For example, liability for Canadian income tax is based on residence and if a contracting state imposed liability for its income tax upon the same basis, it is possible for an individual to be a resident of both Canada and the other state, both for purposes of each of their income tax laws and for purposes of the article regarding residence in international tax treaties. The second way in which such a case of dual residence could arise and would result in double taxation would involve two different contracting states which impose liability to tax based on different criteria. In Taiwan, individual income tax is imposed on the individual's income earned or gained in Taiwan (domestic source income). In Canada, the individual is subject to tax on his/her worldwide income as long as he/she is regarded as resident in Canada. In this situation, if a Taiwanese who immigrates to or does business in Canada and is regarded as resident in Canada has Taiwan-source income, the individual is subject to double tax based on the different criteria in income tax laws of Canada and Taiwan.

Therefore, with a view to avoiding double tax levied on Taiwanese investors in and immigrants to Canada, the first task seems to be 'how to determine the "residence" of the taxpayer?'

2.3.1 The function and purpose of the tie-breaker rules

⁷ *Ibid.*

Commentators suggest that model treaties for the avoidance of double taxation do not normally concern themselves with the domestic laws of the contracting states referring to the conditions of residence.⁸ However, interpretation of treaties still hinges on the local laws of the two contracting states in a bilateral treaty. Two typical cases of conflict occur: (1) between two residences, (2) between residence and source or situs⁹ (as in the case between Canada and Taiwan). In order to solve the conflict and avoid double taxation, three model treaties, namely, (i) the Organization for Economic Co-operation and Development Model Convention (hereinafter referred to as 'OECD Model'), (ii) the United Nations Model Double Taxation Convention Between Developed and Developing Countries (hereinafter referred to as 'U.N. Model'), and (iii) the United States Model Tax Convention (hereinafter referred to as 'U.S. Model'), provide 'tie-breaker rules'.

Article 4 of the three model treaties, relates to 'the case where, under the provisions of paragraph 1, an individual is a resident of both Contracting States',¹⁰ in other words, to the situation where tie-breaker rules would apply. About the function of the tie-breaker rules, the commentary in the OECD Model states: '[T]o solve this conflict special rules must be established which give the attachment to one State a preference over the attachment to the other State. As far as possible, the preference criterion must be of such a nature that there can be no question but that the person concerned will satisfy it in one

⁸ *Ibid.*

⁹ *Ibid.* at 1632.

¹⁰ *Ibid.* at 1633.

State only, and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State'.¹¹ It can be concluded that the purpose of employing the tie-breaker rules is to determine which contracting state has the authority to tax the individual to avoid double taxation.

2.3.2 What are the 'Tie-breaker Rules'?

As mentioned above, the determination of residence for treaty purposes looks first to a person's liability to tax as a resident under the respective taxation laws of the contracting states. However, if a person is a resident in both contracting states under their respective taxation laws, then the OECD, U.S. and U.N. model treaties, proceed, where possible, to assign a single state of residence to such a person, for purposes of the model treaty, through the use of tie-breaker rules. But, what are the tie-breaker rules? They are the 'preference criteria' set out in paragraph 2 of Article 4 in the model treaties, to be applied to determine a single state of residence to avoid double taxation when an individual is a resident of both contracting states. As the preceding criteria defining 'residence' in paragraph 1 of Article 4, do not always provide a clear-cut determination of residence, additional tie-breaker rules are required.

Specifically, the tie-breaker rules are as follows:

(1) Permanent home

¹¹ *Ibid.*

The first test is based on where the individual has a permanent home. 'Home' suggests a greater degree of attachment to a place than mere residence. Whether accommodation is 'available' to the individual is a question of fact, and 'ownership' is irrelevant.¹² The home must be 'permanent'. This means that the individual has arranged to have the dwelling available to him/her at all times continuously, and not occasionally for specific purposes of short duration.¹³ If that test is inconclusive because the individual has a permanent home available to him/her in both States, then, he/she will be considered to have residence in the contracting state where his/her personal and economic relations are closest.¹⁴

(2) The closest personal and economic relations

This is understood as the centre of vital interests. Regard will be had to his/her family and social relations, his/her occupations, his/her political, cultural or other activities, his/her place of business, the place from which he/she administers his/her property, etc.¹⁵ The circumstances must be examined as a whole, but it is nevertheless obvious that considerations based on the personal acts of the individual must receive special attention. For example, if a person who has a permanent home in one state sets up a second in the other state while retaining the first, the fact that he/she retains the first in the environment

¹² *Ibid.* at 1633-2. It states that '[a]s regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room)'.

¹³ *Ibid.* For example: travel for pleasure, business travel, educational travel, attending a course at a school, etc.

¹⁴ *Ibid.* at 1633-2.

¹⁵ *Ibid.* at 1633-2.

where he/she has always lived, where he/she has worked, and where he/she has his/her family and possessions, can, together with other elements, be used to demonstrate that he/she has retained his/her centre of vital interests in the first place.¹⁶

(3) Habitual abode

If the test of (2) is also inconclusive, or if he/she does not have a permanent home available to him/her in either state, he/she will be treated as a resident of the contracting state where he/she maintains an habitual abode.¹⁷ 'Habitual' connotes regular and repeated use over a period of time, although no specific period is laid down in Article 4

(2). As the OECD Commentary states:

In stipulating that in the two situations which it contemplates preference is given to the Contracting State where the individual has an habitual abode, Subparagraph (b) does not specify over what length of time the comparison must be made. The comparison must cover a sufficient length of time for it to be possible to determine whether the residence in each of the two states is habitual and to determine also the intervals at which the stays take place.¹⁸

In other words, the issue of whether an individual has an habitual abode in a treaty country is relative, and is largely based on a comparison of length and frequency of visits to each place. If he/she has an habitual abode in both States or in neither of them, then the next test is citizenship or nationality.

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ *Ibid.* at 1633-3. (Commentary 19 on the OECD Model).

(4) Citizenship or nationality

He/she will be treated as a resident of his/her contracting state of citizenship (in the U.S. Model) ,or of nationality (in both the OECD Model and the U.N. Model).

(5) The competent authorities

If he/she is a citizen (in the U.S. Model) or national (in the OECD Model and the U.N. Model) of both states or of neither of them, the matter will be decided by the competent authorities of the contracting states by mutual agreement. The rule at this stage is the same in the three treaties.

2.3.3 Use of the tie-breaker rules

In order to understand the mechanism of the tie-breaker rules, it is necessary to appreciate why they are applied in a specific order. The order of the tie-breaker rules is based on the degree of 'closeness' of the individual to the contracting states. In the sequence, once a criterion is adequate to solve the conflict, the subsequent criteria need no longer be considered. For instance, the Commentary of the OECD Model states:

The Article gives preference to the Contracting State in which the individual has a permanent home available to him. This criterion will **frequently be sufficient enough** to solve the conflict, e.g. where the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State.¹⁹

¹⁹ *Ibid.* at 1633, 1633-2.

The intent of the mechanism of tie-breaker rules is to avoid double taxation by determining the single 'residence'. It is considered that the residence is that place where the individual owns or possesses a home. This home must be permanent and the individual must have arranged and retained it for his/her permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration. The permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him/her at all times continuously, and not occasionally for reasons of, for example, travel for pleasure, business travel, education travel,....etc. If the individual has a permanent home in both contracting states, paragraph 2 (of each model treaty) gives preference to the state in which the individual has his/her centre of vital interests. In cases where the residence cannot be determined by reference to this rule, paragraph 2 provides, as subsidiary criteria, first habitual abode, and then nationality (in the OECD Model and the U.N. Model) or citizenship (in the U.S. Model). If this is still not adequate, the question shall be solved by mutual agreement between the states concerned according to the procedure laid down in Article 25 of each model treaty.

3. Political Dilemma -- Recognition Status Issues

3.1 Problem of Taiwan

Even though a treaty is the most efficient mechanism by which to solve double taxation problems, nonetheless, the political dilemma that arises is how can a nation enter into a treaty with a jurisdiction that it does not recognize as a country (in this case, Taiwan)? Put plainly, the political dilemma is caused by the general non-recognition of Taiwan as a nation state by most countries in the world. 'A Briefing Book', provided by the Canadian Trade Office, states that: '[f]ollowing the communist victory on the Chinese mainland in 1949, ... The People's Republic of China continues to regard Taiwan as a province of the mainland and pursues an eventual reunification. ... Only 29, mostly small, Central American, Caribbean and African nations, plus the Vatican, have diplomatic relations with Taiwan. South Africa's decision to switch recognition to the PRC at the end of 1997 was a setback. [Moreover,] Taiwan is rejected from rejoining the United Nations (since 1971)'. The PRC's unwillingness to renounce the use of force has contributed to Taiwan's political and economic instability in recent years and has also resulted in a "go-slow" policy for Taiwanese investment in mainland China'.²⁰

3.2 Non-recognition

Non-recognition is the converse of recognition. 'Recognition has been described as: "The free act by which one or more States acknowledge the existence on a definite territory of a human society politically organized, independent of any other existing State, and capable of observing the obligations of international law, and by which they manifest

²⁰ Canadian Trade Office in Taipei ("CTOT"), *Taiwan -- A Briefing Book* (Taipei: Canadian Trade Office in Taipei, 1998) at 5.

therefore their intention to consider it a member of the international Community". This description distinguishes two elements in an act of recognition. It confirms first that the claimant to recognition must satisfy the legal criteria²¹ for statehood. It goes on to explain that the recognizing state is publicly expressing its decision to respect the claimant as an independent sovereign equal'.²²

There is a distinction between the recognition accorded to a state and the recognition accorded to a government. The Canadian Practice of Recognition of States (1972) says that '[in a letter dated July 23, 1971, written by the Secretary of State for External Affairs, as] far as recognition of states is concerned, the Canadian Government must first be satisfied that any entity claiming statehood meets the basic requirements of international law, that is, an independent government wielding effective authority over a definite territory. When these conditions appear to be fulfilled, the timing of recognition is determined in accordance with Canadian national interests, given the political and economic consequences of recognition. Once granted, state recognition survives changes in governments, unless it is explicitly withdrawn'.²³ On the other hand, Canada has generally ceased the practice of recognizing foreign governments. 'Subsequently on

²¹ The criteria for recognition of states are that 'States will generally accord recognition to an entity if the latter satisfies the requirements spelt out in the Montevideo Convention -- defined territory; permanent population; independent government; capacity to engage in relations with other international persons. If the governmental regime appears effective and stable, then recognition will be accorded'. See *supra* note 1 at 79.

²² Kindred H. M., ed., *International Law Chiefly as Interpreted and Applied in Canada*, 5th ed. (Toronto: Emond Montgomery Publications Limited, 1993) at 248.

²³ See: Canadian Practice of Recognition of States (1972), 10 *Can. Y.B. Int. L.* at 308-9. See also *supra* note 22 at 250-251.

November 9, 1988, the Secretary of State for External Affairs announced that Canada would no longer continue the practice of recognizing foreign governments but would follow the so-called Extradite doctrine of recognizing only new or altered states. In making this change in policy, Canada has fallen into line with the approach of the United States, Britain, France and many other countries, which either explicitly or tacitly follow the same practice'.²⁴

Recognition is of importance as 'it is concerned with status, that is, the status of the entity in question (i) on the international scene and (ii) within the municipal legal system of the recognizing state'.²⁵ The effect of recognition/non-recognition at the international level is that under international law the effect of recognition is that the state or government that is recognized thereby acquires not only the respect of the recognizing state for all the rights and privileges but also the duties associated with its new found authority. The principal measure of this status is admittance to the full range of international processes for the protection of a state's rights and duties. Thus, the recognized state or government can then enter into diplomatic relations with other states by exchanging representatives and may conclude treaties with them. Non-recognition, with its consequent absence of diplomatic relations, may limit an unrecognized regime in pressing its rights, or other states in asserting its responsibilities, under international law. However, non-recognition does not necessarily affect the existence of such rights and

²⁴ *Ibid.* at 252 - 253.

²⁵ See *supra* note 1 at 76.

duties.²⁶ In other words, 'non-recognition does not give an entity "carte blanche" to act as it wishes. For example, in 1957 compensation was demanded by the British from the unrecognized Taiwan government for damage done by Taiwan forces to British vessels. An unrecognized entity has responsibilities which the international community requires it to discharge'.²⁷ On the other hand, the effect of non-recognition at the municipal law level is, for example, in the United Kingdom practice, the converse of the consequences of recognition. 'An unrecognized state or government does not have *locus standi* in the British courts; does not enjoy immunity from the jurisdiction of the British courts; its legislative and administrative measures will be denied effect by British courts'.²⁸

3.3 Alternatives

In response to its political dilemma, Taiwan has successfully developed its pragmatic diplomatic foreign policy. '[T]aiwan has achieved success in presenting itself as a newly industrialized economy; this assisted it in joining multilateral organizations like APEC (it participates as Chinese Taipei). Its major economic role has meant that most nations maintain strong unofficial ties. Chinese Taipei has applied for membership in the World Trade Organization (WTO) as a separate customs territory, [an application that] Canada supports'.²⁹ As for Taiwan's pragmatic foreign policy, a report indicates that '[T]aiwan's

²⁶ See *supra* note 23 at 257.

²⁷ See *supra* note 1 at 78, 84.

²⁸ *Ibid.* at 84 - 85.

²⁹ See *supra* note 20 at 5.

formal title, the Republic of China, implies sovereignty over Mainland China (the People's Republic of China - PRC). Taiwan has officially renounced claims to sovereignty over the mainland, but supports a one-China policy and eventual reunification - when democratic and economic conditions on the mainland permit. At present Taiwan has full diplomatic relations with 29 countries and the Vatican. Taiwan's desire for an international identity is its foremost foreign policy, which it pursues with an active "pragmatic diplomacy".

Excluded from the United Nations since 1971, when "China's" seat switched to the PRC, Taiwan now campaigns for its readmittance to the United Nations using a "dual recognition" formula, which would involve a shared "China" seat. The PRC actively opposes this. Taiwan is lobbying hard to receive bilateral assurances or observer status in lieu of official participation in various multilateral organizations. It unilaterally applies many international standards, seeking to be a responsible international player. Taiwan has achieved a measure of success in presenting itself as a newly industrialized economic entity, a characterization that assisted in joining APEC and the ADB (Asian Development Bank). Its application for WTO membership as a developed customs territory is supported by most Contracting Parties, including Canada, if there are satisfactory commitments to open its economy. Once this process is complete, Taiwan will pursue participation in the OECD'.³⁰

Despite most countries' non-recognition of Taiwan, Taiwan has made a great effort in representing itself as an entity with strong economic power in the international arena.

³⁰ *Ibid.* at 11.

'Taiwan is one of Asia's economic dragons, enjoying an average 8.6 % growth for three decades. Taiwan has transformed itself into the world's 19th largest economy with annual per capita income of US \$14,200 (PPP) in 1996'.³¹ Taiwan's leadership has made a significant economic policy shift, which is committed to industrial and infrastructure upgrading and to enhancing Taiwan's investment climate. To this end, the leadership plans on establishing Taiwan as a credible Asia-Pacific regional operations center (APROC) in six key sectors: machinery, offshore shipping, air, telecommunications, finance, and media.³² Moreover, regarding the potential of Taiwan's market, a report also states that: '[T]aiwan's economy represents substantial trade opportunities for foreign firms with commitment and good connections. Taiwan boasts one of the world's fastest growing economies, with low inflation, steady growth and US\$ 84 billion in foreign currency reserves, the fourth largest in the world. Over the next few years, Taiwan has allocated billions of dollars to a range of domestic priorities including infrastructure, transportation, telecommunications, electronics, information technology, machinery, environment, aerospace, health care, chemicals, and advanced materials projects. Programs over the next decade include C\$ [Canadian Dollars] 200 billion in infrastructure construction, C\$ 12 billion in telecommunications and C\$ 15 billion in environmental protection measures-all to be implemented fully by 2005'.³³

³¹ *Ibid.* at 4.

³² *Ibid.* at 12.

³³ *Ibid.* at 4.

Due to the factual economic power of Taiwan, '[m]ost members of the international community, Canada included, do not formally recognize Taiwan as a sovereign state, but all maintain strong unofficial ties at the personal and trade/investment level with this economy'.³⁴ For example:

(1) Australia-Taiwan economic/trading relations:

According to Australia's 1995 House of Representatives Official Hansard,

[T]aiwan was Australia's fifth most important trading partner in Asia and is surpassed only by Japan, South Korea, China and Singapore. Overall, Taiwan provided our [Australia's] sixth largest export market in 1995 with something like \$3.3 billion worth of Australian exports finding their way to Taipei. Although the trade balance between our two countries [Australia and Taiwan] is in our [Australia's] favour at the moment, it is not a one-way street. Imports from Taiwan were worth about \$2.6 billion in 1995. ... In all areas our [Australia and Taiwan's] links continue to strengthen and to grow. Tourism from Taiwan has grown rapidly since 1990. Air links between our two countries--first opened in 1991--increased some 47 per cent to March 1993. Student numbers from Taiwan increased by over 100 per cent between 1990 and 1995 when it became the seventh largest source market for students visiting Australia.³⁵

The above information was provided by one member of the House of Representatives in Australia to favour the signing of a tax agreement between Australia and Taiwan. It can be concluded that, from the numbers provided above, Australia and Taiwan's bilateral economic relations are strong and steadily growing.

(2) New Zealand - Taiwan economic/trading relations:

³⁴ *Ibid.* at 4.

³⁵ House of Representatives Official Hansard (in Australia), "Parliamentary Debates", (No. 7, 1996 20, 21, 22 August 1996) at 3365 (by Mrs. Crosio). This is the comment made by Mrs. Crosio, on the Australia-Taiwan Tax Agreement.

Taiwan is one of New Zealand's major foreign trade partners, as well as one of its main sources of foreign investment, together with the United States, Australia, and the U.K..³⁶ According to New Zealand Official Yearbook(s), Taiwan is one of the top ten countries for exports and imports in New Zealand.³⁷ The figures indicate that in recent years, from 1991 to 1996, the value of exports (from New Zealand to Taiwan) and imports (from Taiwan to New Zealand) are as follows³⁸.

(\$ N.Z. million)

	1991	1992	1993	1994	1995	1996
Exports	315.7	430.8	486.7	507.3	632.3	571.6
Imports	384.7	428.6	483.1	518.1	566.6	525.3

It is also stated in the New Zealand Official Yearbook 1997 that '[t]he Taiwanese market for New Zealand products is of continuing importance and exports of foodstuffs in particular are expected to increase. ... New Zealand's comparative advantage in building products lies principally in wood, where ... Taiwan [is] already a major buyer. ... [With respect to non-food consumer products, including apparel and sporting goods,] [A]s purchasing power and affluence increase in Taiwan ... [this] country will represent an

³⁶ See: The Economist Intelligence Unit (EIU), *Investing, Licensing & Trading (in New Zealand)* (New York: The Economist Intelligence Unit, 1998) at 7, 37. It says that 'the New Zealand economy is highly dependent on foreign trade ... Trade with Australia has increased significantly ... The other significant trade development is the emergence of Asian countries, particularly Japan, South Korea, Taiwan, China and Hong Kong as major trading partners'.

³⁷ See: Statistics New Zealand, *New Zealand Official Yearbook 1997*, 100th ed. (Wellington: GP Publications, 1997) at 565.

³⁸ See: Statistics New Zealand, *New Zealand Official Yearbook 1995*, 98th ed. (Auckland: Statistics New Zealand, 1995) at 557, 558. See also *supra* note 37 at 563, 565.

emerging consumer market for New Zealand'.³⁹ It can be concluded that Taiwan has been a major trading partner with New Zealand, particularly in the Pacific Rim. The two-way flow of business activities between New Zealand and Taiwan shows great potential in their growing bilateral economic relations.

(3) Vietnam - Taiwan economic/trading relations:

According to a recent report, Taiwan has been the number two foreign investor in Vietnam for the last ten years.⁴⁰ Specifically, direct Taiwan investment in Vietnam had reached U.S.\$ 1.53 billion as of the end of 1993, making Taiwan the top foreign investor in that country in 1993.⁴¹ Two-way trade between Taiwan and Vietnam exceeded U.S.\$ 600 million in 1993, with Taiwan enjoying a trade surplus of U.S.\$ 350 million.⁴² In the same year (1993), Taiwan's large investment, up to nearly U.S.\$ 1.2 billion, has been poured into some 70 projects in Vietnam.⁴³ Taiwanese investors have played an important role in the Vietnamese economy. '[U]p to January, 1993, the Vietnamese government has approved 113 applications by Taiwan investors for investments worth over U.S.\$ 1.53

³⁹ See *supra* note 37 at 566.

⁴⁰ See: The Economist Intelligence Unit (EIU), *Investing, Licensing & Trading (in Vietnam)* (New York: The Economist Intelligence Unit, 1998) at 14. This report states that '[t]he top ten foreign investors in Vietnam over the past ten years are, in rank order, Singapore, Taiwan, Hong Kong, Japan, South Korea, France, Malaysia, the United States, Thailand and the British Virgin Islands'.

⁴¹ "Vietnam: Taiwan to Sign Four Economic Agreements Latter This Year" *Reuter Textline BBC Monitor Service: Far East* (4 April, 1994). (Abstracted From Lexis).

⁴² *Ibid.*

⁴³ Dung N., "Vietnam: Taiwan's IECF to Provide Soft Loans" *Reuter Textline Vietnam Investment Review* (10 May, 1993). (Abstracted From Lexis).

billion, making Taiwan the top foreign investors in Vietnam'.⁴⁴ Taiwan is also a supporter for Vietnam to boost its economy. According to the news released in May, 1993, 'Taiwan's International Economic Cooperation Fund (IECF) will supply Vietnam with U.S.\$ 15 million in soft loans for the development of small and medium-sized enterprises, said then Director-General of the Taipei Economic and Cultural Office in Ho Chi Minh City. ... [Besides,] another aid package worth U.S.\$ 30 million is soon to be signed between Vietnam and Taiwan's IECF'.⁴⁵ To facilitate the business activities of Taiwanese investors in Vietnam, Taiwan since 1992 has established two Economic and Cultural Offices in Vietnam, one in Ho Chi Minh City and one in Hanoi.⁴⁶ As a result, the first round of negotiations between Taiwan and Vietnam on a tax agreement, in order to avoid double taxation and to exchange tax information, was initiated in Aug. 1993.⁴⁷ In addition, some other economic agreements, a labour accord, a trade agreement and a temporary import accord, were also under discussion to further boost bilateral economic cooperation and commercial exchanges.⁴⁸ As then Economic Affairs Minister P. K. Ching said: '[t]o avoid double taxation on our investors in Vietnam, we hope to sign a tax exemption agreement with Hanoi as soon as possible. ... On the other hand, Vietnam is

⁴⁴ See *supra* note 41.

⁴⁵ See *supra* note 43.

⁴⁶ *Ibid.*

⁴⁷ "Taiwan: ROC, Vietnam Starting Talks on Tax Agreement" *Reuter Textline China Economic News Service* (17 August, 1993). It is noted that '[aside] from avoiding troublesome duplication of taxation for enterprises in the two nations, MOF [Ministry of Foreign Affairs of Taiwan] officials said the bilateral pact is expected to help divert Taiwan investments from the Chinese mainland, uplift relations with Vietnam, acquire more correct information in fighting against drug smuggling from Vietnam, and collect data concerning shipments of Chinese mainland products to Taiwan via Vietnam'.

⁴⁸ See *supra* note 41.

eager to sign a labour accord with Taiwan so that its citizens will be able to enter Taiwan's labour market'.⁴⁹ It can be reasonably concluded that the reasons for negotiating these agreements are based on the bilateral economic and trading relations between Taiwan and Vietnam.

Even though this thesis is intended to focus on the discussion of avoiding double taxation on individual income, the analysis of the issue is inextricably linked to corporate income. In my view, this linkage is because the economic and trading relations between two countries are the key to making the governments of contracting states take seriously the issue of whether to have a tax treaty (agreement) or not. With respect to the avoidance of double taxation and the prevention of fiscal evasion, three countries have already signed tax agreements with Taiwan. Australia and Taiwan, on May 29, 1996, signed an 'Agreement' (hereinafter referred to as 'Australia-Taiwan Tax Agreement') through two private⁵⁰ sector organizations, namely, 'The Taipei Economic and Cultural Office' and 'The Australian Commerce And Industry Office'.⁵¹ New Zealand and Taiwan, on

⁴⁹ *Ibid.*

⁵⁰ Professor Rick Krever, in his comment on the Australia-Taiwan Tax Agreement, has noted that 'the double tax treaty is actually an agreement between two "private" sector organizations: the Australian Commerce and Industry Office established by the Australian Chamber of Commerce in Taipei, and the Taipei Economic and Cultural Office in Canberra'. See *infra* note 138 at 102. However, some people may question whether or not the Australian Chamber of Commerce should be described as a private sector organization, as it may have some relationship to the government, and they prefer it to be described as a semi-governmental organization. In this thesis, the Australian Chamber of Commerce is considered to be a private sector organization, as are the New Zealand Commerce and Industry Office, and the Vietnam Economic and Cultural Office in Taipei described in footnotes 52 and 53.

⁵¹ The full name of the agreement titled: 'AGREEMENT BETWEEN THE TAIPEI ECONOMIC AND CULTURAL OFFICE AND THE AUSTRALIAN COMMERCE AND INDUSTRY OFFICE CONCERNING THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME'.

November 11, 1996, also signed an 'Agreement' through two private sector organizations, namely, 'The Taipei Economic and Cultural Office in New Zealand' and 'The New Zealand Commerce and Industry Office'.⁵² Vietnam and Taiwan, on April 6, 1998, also signed an 'Agreement', through two private sector organizations, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.⁵³ These tax agreements were all signed on the basis of the economic ties the countries have with Taiwan and have nothing to do with political recognition. It can be concluded that these tax agreements which were signed by two private sector organizations are the alternatives to the formal tax treaties, which can only be concluded between countries having international personalities.

3.4 Canada and Taiwan Should Have a Treaty / an Agreement

In the light of the three previously signed tax agreements, Canada could also have a tax agreement with Taiwan, signed by two private sector organizations -- The Canadian Trade Office in Taipei and The Taipei Economic and Cultural Office in Canada. Despite

⁵² The full name of the agreement titled: 'AGREEMENT BETWEEN THE TAIPEI ECONOMIC AND CULTURAL OFFICE IN NEW ZEALAND AND THE NEW ZEALAND COMMERCE AND INDUSTRY OFFICE FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME'.

⁵³ The full name of the agreement titled: 'AGREEMENT BETWEEN THE VIETNAM ECONOMIC AND CULTURAL OFFICE IN TAIPEI AND THE TAIPEI ECONOMIC AND CULTURAL OFFICE IN HANOI FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME'.

The tax agreement was signed on April 6, 1998 in Hanoi, Vietnam, by the Taipei Economic and Cultural Office in Vietnam (represented by Director-General Hu Chia-chi) and the Vietnam Economic and Cultural Office in Taipei (represented by Mr. Dang Dinh Luu). The tax agreement has been in effect since May 6, 1998. For details, see: the Official Financial Report (Tsai Chung Bu Gung Bau, in Chinese) by the Ministry of Finance of Taiwan, vol. 36, in June, 1998.

Canada's non-recognition of Taiwan, the signing of an agreement between Canada and Taiwan is still possible, mainly due to the strong economic power of Taiwan in the international arena, and the trading relations that Taiwan keeps with Canada.⁵⁴ The Briefing Book has noted that:

Canada ceased diplomatic recognition of the 'Republic of China' (Taiwan) in 1970. While Canada has observed a 'one-China' policy (formally recognizing only the People's Republic of China), extensive economic, trade and people-to-people contacts continue on an unofficial basis. Since 1992, senior-level visits from both sides have reinforced Canada's flourishing presence in Taiwan. Canada-Taiwan trade has grown steadily, reaching close to CAD\$ 4.6 billion in 1996. Taiwan's surplus is approximately CAD\$ 800 million, reflecting a number of barriers to [Canada's] exports. Canada's people-to-people links with Taiwan are growing with substantial increases in tourism, education, and immigration. Visitor visa issuance to Taiwanese continues to grow -- over 100,000 in 1995 and up another 18 % in 1997 to reach 140,000. Taiwanese tourists added over CAD\$ 200 million to the Canadian economy in 1997, and they spend on average more money per trip than tourists from any other nation except Japan. In addition, over 6,000 Taiwanese students currently studying in Canada inject some CAD\$ 180 million into the Canadian economy annually'.⁵⁵

Some statistics are provided with respect to Canada's major exports to and imports from Taiwan, which is indicative of the bilateral economic relations between Canada and Taiwan. '[M]ajor Canadian exports [are]: [o]rganic chemicals; electrical equipment; gold, forestry products (pulp, wood, paper); transportation equipment; boiler machinery; raw hides and skins, aircraft, coal, nickel. Major Canadian imports [are]: [m]achinery;

⁵⁴ 'Taiwan is Canada's 9th largest trading partner; Canada is Taiwan's 13th largest market'. See *supra* note 20 at 12.

⁵⁵ *Ibid.*

mechanical and electrical equipment; iron and steel articles; vehicles parts and accessories; toys; furniture; machine tools; plastic articles, textiles and clothing, base metal articles'.⁵⁶

The economic ties that Canadian companies, individuals and officials have kept with Taiwan are illustrated as the follows.

[1] Trading partners for the future: Taiwan is Canada's ninth largest trading partner and the fourth largest in Asia, with bilateral trade totaling C\$4.5 billion in 1996. Canada is also one of Taiwan's largest export markets. Given the complimentary trade and investment objectives, bilateral trade is expected to continue to grow well into the next century.

[2] Soaring aerospace sales: Canada's Bombardier Aerospace is now Taiwan's third largest supplier of commercial aircraft, with 14 de Havilland Dash-8's sold to Great China Air over the last two years. Bell Helicopter also recently sold four Bell 412 helicopters and two Bell 430 helicopters to Daily Air Corp.

[3] Keeping Taiwan connected: cellular telephones and beepers are quickly becoming commonplace in Taiwan society, and Canada's Northern Telecom is ensuring that the growing demand for service is met. Nortel has won contracts to build 788 of the 890 GSM base-stations planned for Taiwan and its DCS 1800 digital communications system equipment is being used to add 1 million telephone lines to Taiwan's existing cellular network.

[4] Ensuring a greener tomorrow: with Taiwan's tough new environmental regulations coming into effect, a myriad opportunities are opening up for Canada's green technology providers. Some like Canada's Perma are making Taiwan a safer place with the latest in hazardous waste incineration technology, while others like Aqua Guard Spill Response Ltd. are helping keep Taiwan's harbours clean.

[5] Taiwan on the move: the Taipei City Government is helping to clean up the environment with the recent commitment to purchase 60 environmentally-friendly CNG buses from Canada's Orion Bus Industries. Taiwan also imports over C\$ 100 million worth of Canadian manufactured cars annually.

[6] Providing world-class innovation: when looking for leading-edge technology, Taiwan looks to Canada. Arcanco, which devised Toronto's Skydome Stadium, is designing the roof to Taipei's Domed Stadium. Vessels in distress off the Taiwan coast are now brought to safety with the help of CAL Corporation's advanced black box technology.

[7] Opening financial markets: drawn by Taiwan's increasing affluence and commitment to financial liberalization, five Canadian banks, one trust company and two insurance companies are actively carving a niche for themselves in the Taiwan

⁵⁶ *Ibid.* at 6.

market.

[8] Investing in Canada: developments in Canada's agri-food, hi-tech and life science sectors are attracting Taiwan's ample investment dollars. Taiwan's Central Investment Holding has committed to invest C\$ 5 million into Montreal's MDS life sciences fund. Yuan Yi Agricultural and Livestock Enterprise Co.'s investment in a new hog processing facility in Lethbridge is expected to inject over C\$ 850 million into Alberta's economy annually.

[9] Winning Taiwan's hearts, and stomachs: as consumers become increasingly health-conscious, more Taiwanese families are buying pure and natural Canadian food products, such as Canadian beef, seafood, canola oil, bottled water, maple syrup, Yogen Fruze yogurt, St. Cinnamon's buns, Clearly Canadian, wine, beer and Seagram's whiskey. Canada exported over C\$ 155 million worth of agricultural products to Taiwan in 1996.

[10] Jumping across the pond: fourteen direct, non-stop flights per week help ferry the increasing number of businesspeople and tourists traveling between Canada and Taiwan. Between 1991 and 1996, the volume of Taiwanese travelers to Canada jumped by 227%. This rise continued in 1997 with Canada greeting over 140,000 Taiwanese visitors. CTOT [Canadian Trade Office in Taipei] breaks records every day as Canada's highest visitor visa issuance office in the world. Dramatic growth in outbound travel from Taiwan resulted in over 130,000 Taiwanese visiting Canada in 1996, a 25 % increase over 1995. The Taiwanese travel market is Canada's fourth largest source of Asian tourists. Taiwanese also rank high relative to other countries in terms of average expenditures at nearly CDN \$ 2,000 per person per trip. In 1996, Taiwanese tourists annually contributed over CDN \$ 200 million to the Canadian economy.

[11] Living in the best place on earth: attracted by a better quality of life, over 14,700 new Taiwanese immigrants arrived in Canada in 1996, the majority of whom injected thousands of dollars into the economy as investor-class immigrants.

[12] Getting a head start: drawn by world-class programs and a multi-cultural environment, more and more Taiwanese students are applying to study in Canada. In 1996, CTOT issued over 3,000 student visas and promoted Canadian schools through successful education fairs islandwide. The 1997 CTOT-organized Canadian Studies Conference attracted academics from around the globe to discuss Canada and its role in Asia-Pacific.

[13] Setting trends in fashion: Canadian fashions have hit the streets to Taiwan. Canadian designer Simon Chang has enchanted audiences at fashion shows across Taiwan and his designs are now carried exclusively by Far Eastern Department Stores. For quality casual wear, Taiwanese shop at one of five Roots outlets around Taiwan. Today's hip young women wear makeup by Toronto-based MAC Cosmetics.

[14] Introducing a slice of Canadiana: musical artists as Alanis Morissette and Quebec pianist Steven Barrakatt played to packed audiences in Taiwan in 1997. The market for film in Taiwan is also very significant, second only to Japan in East Asia. A number of Canadian film producers including Alliance, Malofilm and NFB have all sold products in Taiwan. The first Canadian Film Week in Taipei, organized by the CTOT, attracted 8,000 viewers and generated 50 media reports. CTOT's annual Canadian film festival

draws large crowds and has resulted in the sale of commercial rights to three Canadian movies - Double Happiness, Margaret's Museum, and Thirty-two Short Films about Glenn Gould.

[15] Cooperating on international issues: Canadian and Taiwanese officials engage on a range of important bilateral issues, as well as work together as members of effective multilateral organizations such as APEC and the Asian Development Bank.

[16] Exchange of senior-level visits: in recognition of Taiwan's valuable role as a trading partner, Canada's Ministers of Transport, International Trade, Natural Resources, Industry and Revenue have all visited Taiwan in the past four years, together with four Provincial Premiers. Taiwan's Vice Premier and Minister of Finance, Environment, Health, and Mainland Affairs visited Canada in 1995-6, while senior government representatives and business delegations attended the seven APEC Ministerial meetings in Canada in 1997'.⁵⁷

With these statistics and facts, it can be concluded that the economic and trading ties between Canada and Taiwan are getting closer. The two jurisdictions would be better off having a tax treaty or agreement to facilitate their bilateral economic relations and prevent punitive double taxation.

Moreover, the signing of an agreement with Taiwan is not a novel concept to Canada. Taiwan said it had signed a formal air agreement (dated October 22, 1990) with Canada, to facilitate their bilateral commercial relations after Canada severed diplomatic ties with Taiwan and switched its recognition to the People's Republic of China.⁵⁸ However, due to Canada's non-recognition of Taiwan, Canada did not refer to it as a formal air

⁵⁷ *Ibid.* at 8 - 9, 19.

⁵⁸ Taiwan announced in 1990 that it had signed a formal air agreement with Canada to pave the way for the first direct flights between Taipei and Vancouver commencing in December, 1990. It has been reported by the Canada-based *The Globe and Mail* that '[the then] Vice Communications Minister Ma Cheng-fang said under the agreement, Taiwan's flag-carrier China Airlines and Calgary-based Canadian Airlines International Ltd. will jointly operate the direct flights during the initial period starting Dec. 5. Taiwan severed diplomatic ties with Canada in 1970 after Ottawa switched its recognition to Beijing. But trade between Taiwan and Canada has flourished since totaling \$2.75 billion in 1989 according to Taiwanese figures'. See: "Canadian Airlines" *The Globe and Mail* (16 November, 1990) B8.

agreement concluded with Taiwan, instead, putting it in an informal way as a 'Memorandum of Understanding'.⁵⁹ Regardless of what it is called, it enables Canadian Airlines International Ltd. to fly directly from Vancouver to Taiwan, and vice versa. Likewise, Taiwan's flag-carrier China Airlines can fly directly from Taipei to Vancouver, and vice versa.

Following the 'agreement' dated October 22, 1990, Canada and Taiwan signed another 'Memorandum of Understanding'⁶⁰ on July 10, 1995 with respect to reciprocal tax exemption on certain taxes on air transport enterprises by Canada and Taiwan. The purpose of signing this Memorandum of Understanding is to provide reciprocal relief from taxation to air transport enterprises resident on Taiwan and in Canada. It is noted in the preface of the Memorandum that 'The Department of North American Affairs, Ministry of Foreign Affairs, Taipei, and the Canadian Trade Office in Taipei, [n]oting that the

⁵⁹ The full name of the Memorandum of Understanding is: 'MEMORANDUM ON AIR SERVICE BETWEEN THE CANADIAN TRADE OFFICE IN TAIPEI AND THE DEPARTMENT OF NORTH AMERICAN AFFAIRS OF THE MINISTRY OF FOREIGN AFFAIRS OF TAIWAN'. (Dated: October 22, 1990). The Memorandum of Understanding was renewed and signed again recently in 1997. The full name of the updated Memorandum of Understanding is: 'SUPPLEMENTARY CONFIDENTIAL MEMORANDUM ON AIR SERVICE BETWEEN THE CANADIAN TRADE OFFICE IN TAIPEI AND THE MINISTRY OF TRANSPORTATION AND COMMUNICATIONS IN TAIPEI'. (Dated: March 19, 1997). This information is provided by the Agreements, Tariffs and Enforcement Directorate Canadian Transportation Agency. It is interesting to see why Taiwan said the first Memorandum of Understanding, from Taiwan's perspective, was a formal air agreement, because it was signed by the Taiwanese government. However, it is quite understandable that Canada referred it as a Memorandum, as from Canada's perspective, it was only signed by the Canadian Trade Office in Taipei ("CTOT"), a non-governmental representative office in Taipei from Canada.

⁶⁰ The full name of the Memorandum of Understanding is: 'MEMORANDUM OF UNDERSTANDING CONCERNING RECIPROCAL EXEMPTION WITH RESPECT TO CERTAIN TAXES ON AIR TRANSPORT ENTERPRISES BETWEEN THE CANADIAN TRADE OFFICE IN TAIPEI AND THE DEPARTMENT OF NORTH AMERICAN AFFAIRS OF THE MINISTRY OF FOREIGN AFFAIRS, TAIPEI'. This information is also provided by the Agreements, Tariffs and Enforcement Directorate Canadian Transportation Agency.

responsible authorities on Taiwan and in Canada intend to provide reciprocal relief from taxation to air transport enterprises resident on Taiwan and in Canada, consistent with the principle of reciprocal benefit, as set out in the Memorandum on Air Services of October 22, 1990; [c]onfirm the following understanding on how the responsible authorities on Taiwan and in Canada will implement the above-noted intention'.⁶¹ This Memorandum was also signed between the Taiwanese government and the non-government representative "CTOT" from Canada.

The existing taxes to which the Memorandum of Understanding (on July 10, 1995) will apply are those as set out in articles 1, 2, 3 and 4 of the Memorandum: Article 1. (a) on Taiwan, the profit seeking enterprise income tax and the business tax; (b) in Canada, the income tax and capital tax imposed under the *Act*, and the goods and services tax imposed under the *Excise Tax Act*, R.S.C. 1985, c. E-15. Article 2. This Memorandum of Understanding will also apply to any identical or substantially similar taxes which are imposed after the date of signature of this Memorandum of Understanding in addition to, or in place of, the existing taxes. Therefore, on Taiwan, air transport enterprises resident in Canada will be exempt from tax on the income, profits or revenue derived from international traffic earned on Taiwan. (See: article 3 of this Memorandum of Understanding.) Likewise, in Canada, air transport enterprises resident on Taiwan will be exempt from tax on: (a) the income, profits or revenue derived from international traffic earned in Canada; (b) the capital represented by aircraft operated by such enterprises in

⁶¹ See: the preface of the Memorandum. This information is provided by the Agreements, Tariffs and Enforcement Directorate Canadian Transportation Agency.

international traffic and by personal property used in the business of transporting passengers or goods in international traffic. (See: article 4 of the Memorandum of Understanding.)⁶²

It can reasonably be predicted that, in spite of the political dilemma, Canada would continue to allow the signing of bilateral 'agreements' in an informal way to serve some specific economic purposes.

4. A Precedent -- the Australia-Taiwan Tax Agreement

With respect to the Australia-Taiwan Tax Agreement, one commentator has noted that

Australia-Taiwan tax treaty: pragmatism prevails In May 1996 Australia signed its latest and most unique tax treaty with Taiwan. ... The principal problem, of course, is how can a nation enter into a treaty with a jurisdiction it does not recognize as existing? Under the terms of the 1972 Joint Communiqué between Australia and the People's Republic of China, Australia recognized the government of the People's Republic as the sole legal government of China and acknowledged the position of the Chinese government that Taiwan is a province of China ... [In order to avoid the political recognition problem,] the double tax treaty is actually an agreement between two "private" sector organizations, the Australian Commerce and Industry Office established by the Australian Chamber of Commerce in Taipei, and the Taipei Economic and Cultural Office in Canberra. While the agreement was nominally prepared by two private organizations, it was of course actually negotiated in unofficial capacity by government officials and looks broadly similar to Australia's other double tax treaties.⁶³

⁶² See: articles 1, 2, 3, and 4 of the Memorandum of Understanding. This information is also provided by the Agreements, Tariffs and Enforcement Directorate Canadian Transportation Agency.

⁶³ See *supra* note 20 at 102.

Despite the complicated international political and diplomatic issues associated with relations with Taiwan, the reasons for signing the Australia-Taiwan Tax Agreement are, nonetheless, due to the trading relations between Australia and Taiwan, and the economic power that Taiwan has exercised in the world.⁶⁴ Put plainly, the signing of the Australia-Taiwan Tax Agreement is intended to facilitate the bilateral commercial relations between the two jurisdictions and political issues are deliberately neglected or ignored.

Australia and Canada are very similar in that politically they do not recognize Taiwan as a state⁶⁵, but economically, Canada, like Australia, has a strong and continuing economic relationship with Taiwan. It can be concluded that the Australia-Taiwan Tax Agreement can be a precedent for the potential Canada-Taiwan Tax Agreement.

5. Bringing a Tax Agreement into Effect

⁶⁴ Mrs. Crosio [quoted in the House of Representatives Official Hansard (in Australia)] said that '[t]wo memorandums of understanding have now been signed between the office representing Australian interests in Taiwan, the Australian Commerce and Industry Office, and the Taiwanese authorities. ... Our relationship with Taiwan both economically and diplomatically is strong and the bill [Taxation Laws Amendment (International Tax Agreements) Bill 1996] before the House is indicative of that'. See *supra* note 35 at 3365. To sum up, the aforesaid bill is used to provide the legal authority for the international taxation agreement between Australia and Taiwan.

⁶⁵ For Australia's non-recognition of Taiwan as a state, see: House of Representative Official Hansard (in Australia), *Ibid.* at 3366. This report states that: 'Taiwan is not a country and that we are still acknowledging it as part of mainland China'. For Canada's non-recognition of Taiwan as a state, see *supra* note 20 at 4. This report states that '[m]ost members of the international community, Canada included, do not formally recognize Taiwan as a sovereign state, but all maintain strong unofficial ties at the personal and trade/investment level with this economy'. Specifically, 'Canada ceased diplomatic recognition of the 'Republic of China' (Taiwan) in 1970. While Canada has observed a "one China policy (formally recognizing only the People's Republic of China), extensive economic, trade and people-to-people contacts continue on an official basis. Since 1992, senior-level visits from both sides have reinforced Canada's flourishing presence in Taiwan'. *Ibid.* at 5. See also: section 3.2 of this chapter regarding non-recognition.

5.1 The Australian Practice

Both in Australia and Canada, a treaty is not automatically effective simply because it has been signed by the executives. In Australia, for a treaty to go into effect, the treaty must be passed by the Parliament in a law. In other words, treaties are only valid once incorporated into domestic law. Non-ratified treaties will have no effect. On 18 June 1997, the Federal Attorney-General in Australia introduced into Parliament the Administrative Decisions (Effect of International Instruments) Bill 1997. The Bill responds to the High Court's 7 April 1995 decision in *Minister for Immigration and Ethnic Affairs v. Teoh* (1995) 183 CLR 273 by providing that, if there are to be changes to procedural or substantive rights in Australian Law resulting from adherence to a treaty, they will result from Parliamentary and not executive action. Therefore, entering into a treaty will not give rise to 'legitimate expectations' in administrative law that the Executive Government and its agencies will act in accordance with the terms of the treaty, where those terms have not yet been incorporated into Australian Law.⁶⁶ As for the legislative power of Parliament in Australia in implementing treaties, and its legal source, it is noted that: '[i]n Australia, there is no provision in the Constitution which gives to treaties the force of internal law, but s. 51(29) of the Constitution allocates to the federal Parliament the power to make laws "with respect to ... external affairs". In a series of

⁶⁶ However, as of September, 1998, the Bill has not yet been passed and enacted into law. See: 1996-97 The Parliament of the Commonwealth of Australia House of Representatives "Administrative Decisions (Effect of International Instruments) Bill 1997 -- A Bill for an Act relating to the effect of international instruments on the making of administrative decisions.

cases [for example, (1) In *R. v. Burgess; ex parte Henry* (1936) 55 C.L.R. 608; (2) In *Koowarta v. Bjelke-Petersen* (1982) 153 C.L.R. 168; (3) In *Commonwealth v. Tasmania* (Franklin Dam) (1983) 158 C.L.R. 1] the High Court of Australia has decided that the external affairs power includes the power to enact legislation performing treaty obligations'.⁶⁷

All of Australia's double tax treaties go into the same law, which is called the International Tax Agreements Act 1953 (hereinafter referred to as 'Act 1953').⁶⁸ Therefore, every time there is a new tax treaty, the new treaty will be added to the schedule of the 1953 Act by legislative amendment.⁶⁹ As stated above, international law does not distinguish between agreements identified as treaties and other agreements. Besides, the Australia-Taiwan Agreement looks similar to tax treaties Australia signed with other countries, even though it is unique in being signed by two private sector organizations. Therefore, the Parliament of Australia tried to bring the Australia-Taiwan Agreement into effect by debating and passing it as the Taxation Laws Agreement (International Tax Agreement) Bill 39, an amendment to Act 1953.

By examining the following statements (quoted in both the House of Representatives' and the Senates' Official Hansards in Australia), it is fair to say that the goal of improving

⁶⁷ See *supra* note 2 at 11-8.

⁶⁸ The International Tax Agreements Act 1953 was formerly called the Income Tax (International Agreements) Act 1953.

⁶⁹ Personal communication, on September 12, 1998, Professor Rick Krever, Deakin University, Australia.

Australia and Taiwan's trade and investment flows led to the conclusion of the Australia-Taiwan Tax Agreement.

For example, in the House of Representatives of Australia, Mr. Latham has noted that:

The Taxation Laws Amendment (International Tax Agreements) Bill seeks to provide the legal authority for an international taxation agreement between the province of Taiwan and the nation state of Australia which was signed on 29 May 1996. The agreement is along the lines of the 36 other agreements currently in force with other countries. The purpose of concluding such agreement is to improve trade and investment flows by agreeing which nation has the rights to tax certain types of income. In this manner the threat of punitive double taxation is overcome.⁷⁰

On the other hand, in the Senate of Australia, Senator Bolkus has noted that:

The bill seeks to provide the legal authority for an international taxation agreement between the province of Taiwan and the nation state of Australia, an agreement which was signed on 29 May 1996. The agreement is in line with 36 other agreements currently in force with other countries. The purpose of concluding such agreements is to improve trade and investment flows by agreeing which nation has the right to tax certain types of income. In this manner, the threat of punitive double taxation is overcome.⁷¹

More specifically, the Australia-Taiwan Tax Agreement is the mechanism to attain the goal of improving their bilateral trade and investment relations. The legal consequence of having the tax agreement is to protect the two-way flow of economic activities from punitive double taxation. In order to avoid additional complex legal procedures to bring the unique Australia-Taiwan Tax Agreement into effect, both Houses allowed the

⁷⁰ See *supra* note 35 at 3364.

⁷¹ Commonwealth of Australia Parliamentary Debates Senate Official Hansard, (Nos 8 and 9, 1996, 9,10,11,12 September and 16,17,18,19 September 1996) at 3387.

agreement to go through the same debate and passage procedure, as used in other tax agreements. The Australia-Taiwan agreement thus became a part of the International Tax Agreement Act 1953 and binding.

Since the Australia-Taiwan Tax Agreement has become binding, double taxation by the two countries is avoided. However, there arises an interesting question as to 'how does an agreement between two non-governmental bodies become law or a binding treaty on the tax authorities of Australia and Taiwan'. Since the Australia-Taiwan Tax Agreement was passed by the Parliament of Australia, and is part of the law (the International Tax Agreement Act 1953), it is a binding agreement and the original signatories to the agreement became irrelevant. That is to say, once the Australia-Taiwan Tax Agreement is incorporated into a law (the International Tax Agreements Act 1953), it takes effect and it does not matter who signed the agreement originally, in this case, two private sector organizations not governments. By doing so, Australia intelligently evaded the political dilemma of recognizing Taiwan as a nation state, and successfully resolved the technical problem of 'how can an agreement between two non-governmental bodies become law or a binding treaty on the tax authorities of Australia and Taiwan'.

5.2 The Canadian Practice

5.2.1 The treaty-making power in Canada

In the case of Canada, '[t]he Canadian Parliament plays no necessary role in the making of treaties. The negotiation and conclusion of a treaty is part and parcel of the conduct of international relations, and the conduct of international relations has always been one of the prerogatives of the Crown'.⁷² The prerogative powers of the Crown, initially reserved for the Queen under s. 9 of the *British North America Act* (Now the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c.11.), are now exercised by the Governor-General.⁷³ Historically, with respect to the treaty-making power in Canada, the assumption in *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c.3, reprinted in R.S.C. 1985, App. II, No.5. (hereinafter referred to as *Constitution Act, 1867*) was that 'the treaty-making power would remain part of the prerogative powers with respect to the conduct of external affairs, which rested with the Sovereign and were exercised on the advice of Her British Ministers'.⁷⁴ Thus, 'in 1867 and for approximately the next half-century, the treaty-making capacity in respect of Canada was vested exclusively in the Imperial Government. However, in the period 1871-1923, procedures slowly evolved by which Canadian Government representatives at first participated in negotiations leading to an imperial treaty affecting Canada (Washington Treaty of 1871), then later came to sign such agreements as a member of the Empire (Treaty of Versailles, 1919), and finally signed such agreements on behalf of Canada (Halibut Fisheries Treaty, 1923)'.⁷⁵ 'This

⁷² See *supra* note 22 at 162.

⁷³ *Ibid.*

⁷⁴ *Ibid.*

⁷⁵ *Ibid.*

new procedure was confirmed at the Imperial Conference of 1926; Canada and other dominions were henceforth to be able to negotiate and enter into treaties affecting their own interests and ratification was to be effected at the instance of the dominion concerned. The dominions were also accorded the right to establish direct diplomatic relations with foreign powers'.⁷⁶

As noted above, the prerogative powers of the Crown, initially reserved for the Queen, are now exercised by the Governor-General. The evolution, however, is : '[i]n the colonial period, the extent of the delegation of the prerogative power was limited by the subordinate position occupied by the colony, but it may be assumed that, upon the achievement of independence those prerogative powers remaining in the Crown passed to the Governor-General, and all such prerogatives are implicitly held by the Governor-General even in the absence of specific delegation'.⁷⁷ In other words, it is reasonable to conclude that 'the powers required by an independent state in fact reside in that state. In addition, the new Letters Patent issued by the Governor-General in 1947 declare: 2. And We do hereby authorize and empower Our Governor-General, with the advice of Our Privy Council for Canada or of any members thereof or individually, as the case requires, to exercise all powers and authorities lawfully belonging to Us in respect of Canada. ... 3. And We do hereby authorize and empower Our Governor-General to keep and use Our Great Seal of Canada for sealing all things whatsoever that may be passed under Our

⁷⁶ *Ibid.*

⁷⁷ *Ibid.* at 162 - 163.

Great Seal of Canada'.⁷⁸ 'From the terms of the Letters Patent, read in conjunction with the 1939 provision for a Great Seal for Canada, it may be concluded that the foreign affairs prerogative is now exercised by the Governor-General'.⁷⁹

To sum up, in Canada, 'the constitutional authority to conclude international agreements is a part of the royal prerogative and, with respect to treaties, is exercised in the name of Canada by the Governor-General, usually on the advice of the Secretary of State for External Affairs. The prerogative powers in respect of foreign affairs and treaty-making devolved upon the Federal executive at the time when Canada became an autonomous member of the British Commonwealth of Nations. In addition, the delegation of the prerogative powers of the Crown in right of Canada to the Governor-General were clearly confirmed by the Letters Patent of 1947'.⁸⁰ Therefore, the executive branch of government has the power to make treaties without the necessity of parliamentary authority. There is no legal requirement that the Parliament give its approval to either the signing or the ratification of a treaty.⁸¹

⁷⁸ *Ibid.*

⁷⁹ *Ibid.*

⁸⁰ *Ibid.* at 164.

⁸¹ See *supra* note 2 at 11-4. In practice, however, '[d]espite the absence of any constitutional obligation to obtain parliamentary approval, it has been the practice of Canadian governments to obtain parliamentary approval of the most important treaties in the interval between signing and ratification'. *Ibid.* at 11-5. The government will lay the treaty before Parliament and move a resolution in each House approving the treaty. The resolution is not in statutory form, and does not receive royal assent. Of all the treaties which Canada ratified between 1946 and 1966 approximately one quarter were submitted to Parliament for approval. However, there is no practice of securing Parliament's approval of treaties which do not require ratification, and these are now the more common kind of treaty. *Ibid.* See also *supra* note 22 at 161 - 168

5.2.2 The implementing of a treaty in Canada

However, the making of a treaty must be distinguished from the implementing of the treaty. '[T]he implementing of the treaty [refers to] the performance of the treaty obligations. As soon as a treaty is made and in force, the states that are parties to the treaty come under an obligation in international law to implement the treaty'.⁸² Therefore, '[i]mplementation is the process of giving effect to a treaty within the national legal system. In Canada, the vast majority of treaties have to be implemented by legislation. This requirement is the result of the constitutional separation of powers. Although the executive in exercise of the royal prerogative may conclude a treaty, it cannot make law. That is the responsibility of the legislature. As a result, a treaty made by the federal government will bind Canada as a country, but its provisions do not affect internal law until they have been implemented by legislation'.⁸³

Put plainly, '[t]he implementation of a treaty, if it involves a change in the internal law of Canada, will require a statute enacted by the Parliament of Canada, or the provincial Legislatures, or both'.⁸⁴ There are many treaties which cannot be implemented without an

⁸² See *supra* note 2 at 11-5. See also *supra* note 22 at 168 - 174.

⁸³ See *supra* note 22 at 168.

⁸⁴ See *supra* note 2 at 11-4. See also *supra* note 22 at 174 - 175. See also: *R. v. Canada Labour Relations Board* (1964), 44 D.L.R. (2d) 440 (Man. Q.B.). In this case, Smith J. said that '[i]f the Agreement of May 5, 1955, between Canada and the United States has the effect of taking away these rights and removing these obligations, it necessarily involves a change in the law of the Territories in so far as these parties are concerned. In my view of the authorities, this would require legislative action by the Parliament of Canada. It has not been suggested that any Act of Parliament has been passed embodying the terms of this Agreement or giving them statutory authority. Though the Agreement was tabled in the House of Commons, as today appears to be the practice with almost all international agreements, such

alteration in the internal law of Canada, for example, 'treaties between Canada and other states relating to patents, copyrights, taxation of foreigners, extradition, and many other matters, can often be implemented only by the enactment of legislation to alter the internal law of Canada'.⁸⁵ There are also many treaties which do not require a change in the internal law of the states which are parties. 'This is true of treaties which do not impinge on individual rights, nor contravene existing laws, nor require action outside the executive powers of the government which made the treaty. For example, treaties between Canada and other states relating to defense, foreign aid, the high seas, the air, research, weather stations, diplomatic relations and many other matters, may be able to be implemented simply by the executive action of the Canadian government which made the treaty'.⁸⁶ Therefore, it can be concluded that, in Canada, with respect to implementing treaties, not all treaties require a statute enacted by the Parliament of Canada (provided that the subjects of a treaty are within the Classes of Subjects enumerated in section 91 of the *Constitution Act, 1867*) to bring the treaty into effect.

However, '[w]hen implementation of a treaty by legislation is necessary, the federal character of Canada again creates difficulties. The *Constitution Acts, 1867* have very little to say about international treaties. Section 132 of the *Constitution Act, 1867* vested the federal Parliament with powers for performing the Obligations of Canada or of any

action cannot have the effect of changing the law affecting these parties, or of making such changes, if any were intended; enforceable in the Courts'.

⁸⁵ See *supra* note 2 at 11-5.

⁸⁶ *Ibid.*

Province thereof as part of the British Empire toward Foreign Countries, arising under Treaties between the Empire and such Foreign Countries'.⁸⁷ However, since 'Canada achieved independent status and "Empire treaties" are no longer concluded, section 132 of the *Constitution Acts, 1867* seems to have become a vestige of the past. Furthermore, Parliament has no special jurisdiction under the residuary clause of section 91 of the *Constitution Acts, 1867* to implement treaties concerning matters within provincial legislative jurisdiction [which is under section 92 of the *Constitution Act, 1867*]. As a result, jurisdiction to adopt laws for the purpose of implementing treaties is determined by the ordinary rules governing the division of legislative powers under the constitution. This was the conclusion of the Privy Council in the well-known *Labour Conventions Case*,⁸⁸ which continues to cloud the performance of treaty obligations by Canada with the uncertainties'.⁸⁹

The result of the *Labour Convention Case* is that, 'according to Lord Atkin, who wrote the Privy Council's opinion, the federal parliament has the power to implement "Empire treaties" under s.132 [of the *Constitution Act, 1867*, hereinafter referred to the same], but no power to implement Canadian treaties under s. 132'.⁹⁰ The key to Lord Atkin's reasoning lies in his assertion that 'for the purpose of the federal distribution of powers

⁸⁷ See: section 132 of the *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c.3, reprinted in R.S.C. 1985, App. II, No. 5.

⁸⁸ *Canada (Attorney General) v. Ontario (Attorney General)*, [1937] A.C. 326, [1937] 1 D.L.R. 673 (J.C.P.C.)

⁸⁹ See *supra* note 22 at 169.

⁹⁰ See *supra* note 2 at 11-12, 11-13. See also *supra* note 22 at 169 - 170, 171.

there is no such thing as treaty legislation as such. This means that legislation implementing a treaty may not be classified as "in relation to" the treaty, but must be classified as in relation to the subject matter with which the treaty deals'.⁹¹ Therefore, in classifying a statute which was required to implement a Canadian treaty, 'one was supposed to disregard the fact that the purpose of the statute was to implement a treaty and look to the substantive subject matter of the statute. If the statute which was required for implementation of the treaty related to a matter allocated by s. 91 [of the *Constitution Act, 1867*] to the federal Parliament, then the federal Parliament would have the power to implement the treaty. If, on the other hand, the statute which was required for the implementation of the treaty related to a matter allocated by s. 92 [of the *Constitution Act, 1867*] to the provincial Legislatures, then the provincial Legislatures would have the power to implement the treaty. For example, it is held in the *Labour Conventions Case* that disregarding the existence of the treaties (the labour conventions), the statutes related to conditions of employment in industry, a matter within the class of subjects "property and civil rights in the province" which was allocated by s. 92(13) [of the *Constitution Act, 1867*] to the provincial Legislatures. The result was, therefore, that it was the provincial Legislatures, and not the federal Parliament, which had the power to enact legislation of the kind necessary to implement the labour conventions. The federal legislation was accordingly unconstitutional'.⁹²

⁹¹ *Ibid.*

⁹² *Ibid.*

The reasoning in the *Labour Conventions* Case is open to criticism and has been criticized as an unduly narrow and literal interpretation of s. 132 to refuse to allow it to continue to cover what is essentially the same subject matter (i.e. Canadian treaties) as Empire treaties. One commentator has noted that even if one agrees with the proposition that s. 132 cannot be extended to cover Canadian treaties, Lord Atkin's conclusion is too sweeping and is difficult to defend. 'Section 132, even if no longer literally applicable to modern treaties, shows by its very existence that treaty legislation is a distinct constitutional "matter" or "value" under the power-distributing provisions of the Constitution, and that it is no part of provincial legislative power. Once it is accepted that a law may be classified as "in relation to" a treaty, as s. 132 seems to insist, then, if s. 132 itself does not apply, the law must fall within the opening words of s.91, which allocate to the federal Parliament the residuary power "to make laws for the peace, order, and good government of Canada". [And the] argument that legislation to implement a Canadian treaty is within the federal power over the peace, order, and good government of Canada was in fact accepted by the Privy Council in the *Radio Reference* (1932) A.C. 304, 312, which was decided shortly before the *Labour Conventions* Case'.⁹³ It can be concluded that this commentator considers s. 132 can be 'strained' or 'tortured' to cover the Canadian treaties. If s. 132 cannot apply, then the legislation to implement a Canadian treaty is absolutely within the federal parliamentary power over the peace, order, and good government of Canada. However, '[t]his does not mean that Canada is always precluded from signing, ratifying or performing treaties upon subjects within the legislative

⁹³ See *supra* note 2 at 11-12, 11-13.

competence of the provinces. The federal government can consult with the provinces before assuming treaty obligations which would require provincial implementation, and if all provinces (or all affected provinces) agree to implement a particular treaty, then Canada can adhere to the treaty'.⁹⁴

5.3 Sub-conclusion

As in Australia, 'Canada's constitutional law, ... does not recognize a treaty as part of the internal (or "municipal") law of Canada. Accordingly, a treaty which requires a change in the internal law of Canada, [for example, treaties between Canada and other states relating to taxation of foreigners], can only be implemented by the enactment of a statute which makes the required change in the law'.⁹⁵ In these cases, 'treaties can often be implemented only by the enactment of legislation to alter the internal law of Canada'.⁹⁶ 'It follows that the courts of Canada (and of other countries with British-derived constitutions) will not give effect to a treaty unless it has been enacted into law by the appropriate legislative body'.⁹⁷

⁹⁴ *Ibid.* at 11-14. See also *supra* note 22 at 168, 170 - 171.

⁹⁵ See *supra* note 2 at 11-5.

⁹⁶ *Ibid.* See also: Macdonald, "International Treaty Law and the Domestic Law of Canada" (1975) 2 Dal. L.J. at 307.

⁹⁷ See *supra* note 2 at 11-6, 11-7. It is noted that 'or, to put the same proposition in another way, the courts will apply the law laid down by statute or common law, even if it is inconsistent with a treaty which is binding upon Canada. In a case where Canada's internal law is not in conformity with a treaty binding upon Canada, then Canada is in breach of its international obligations and may be liable in international law to pay damages or suffer other sanctions, ... The only concession which the Canadian courts have been prepared to make in recognition of Canada's international obligations is to interpret statutes so as to conform as far as possible with international law. But where the language of a statute is clearly and

Therefore, if a tax treaty (an agreement) is signed between Canada and Taiwan, in order to bring the treaty into effect, Canada, will also have to follow the procedures that Australia developed to implement the Australia-Taiwan Tax Agreement. In doing so, Canada, can not only successfully avoid the political dilemma of its non-recognition of Taiwan as being a nation state, but can also avoid the double taxation problem.

6. A Hypothetical Treaty Between Canada and Taiwan

Having a double taxation agreement between Canada and Taiwan is also suggested by Canadian Trade Office In Taipei. It has been noted that:

For Canada, the absence of a Double Taxation Agreement (DTA) and a Foreign Investment Protection Agreement (FIPA) has been raised by Taiwanese and Canadian businesses as impediments to more Taiwanese investment in Canada. These Agreements can help attract investment capital from Taiwan by lowering the non-resident withholding tax from 25% to 10-15 % in treaty countries. Taiwan has DTAs with a number of countries including Australia and New Zealand and investment agreements (FIPA) with the U.S., Malaysia, Argentina, and Indonesia. Australia, New Zealand, Italy and Vietnam are currently negotiating FIPAs. Work is underway in Canada to develop a DTA text.⁹⁸

For the discussion of which model treaty a hypothetical Canada-Taiwan Tax Agreement would follow, it is worth examining the similarities and differences of three model treaties, namely, the OECD, the U.N., and the U.S. models.

unmistakably inconsistent with a treaty or other rule of international law, then there is no room for interpreting it into conformity with the international rule and the statute must be applied as it stands'.

⁹⁸ See *supra* note 20 at 21.

6.1 The Three Model Tax Treaties

The 1963 OECD Draft Convention (Model Treaty) is a starting point for resolving double taxation. It has been used to facilitate bilateral negotiation between OECD Member countries and to reach a desirable consistency between their bilateral conventions for the benefit of both taxpayers and national administrations. In addition, the impact of the Draft Convention of 1963 has extended outside the OECD areas. It has been used as a basic document of reference in negotiations between Members, between Member and non-Member countries, between non-Member countries, as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems.⁹⁹ In other words, the OECD Model has been widely accepted and used by many countries and has been the most influential model treaty.

The U.N. Model was developed to respond to the concern that although existing treaties between industrialized countries sometimes require the country of residence to give up revenue, more often, it is the country of source which gives up revenue.¹⁰⁰ Such a pattern may not be equitable in treaties between developing and industrialized countries because income flows are largely from developing to industrialized countries and the revenue

⁹⁹ Ault H. J. , *Comparative Income Taxation: A Structural Analysis* (Den Haag: Kluwer Law International, 1997) at 467-468.

¹⁰⁰ See *supra* note 5 at 2003-2014.

sacrifice would be one-sided.¹⁰¹ The U.N. Model represents a compromise between the source principle and the residence principle, and it gives more weight to the source principle than does the OECD Model. The U.N. Model was prepared by the Fiscal and Financial Branch of the Department of International Economic and Social Affairs of the United Nations Secretariat, and it reproduced most of the OECD Model in order to take advantage of the accumulated technical expertise embodied in it. There was no intention to make major changes to the OECD Model.¹⁰² That is to say, even though the U.N. Model is intended to protect the developing countries, the U.N. Model basically has followed the OECD Model¹⁰³.

Similarly, the U.S. Model follows the OECD Model as well, but has provided more criteria to resolve the conflict where double taxation arises in consequence of double residence, or as a consequence of taxation in the state of residence and in the state of source or situs.¹⁰⁴

6.2 Comparison of the Three Model Treaties with Respect to 'Residence'

6.2.1 Comparison of the OECD Model and the U.S. Model:

¹⁰¹ *Ibid.*

¹⁰² *Ibid.* at 2006.

¹⁰³ *Ibid.*

¹⁰⁴ See: article 4 of the United States Model Income Tax Convention of September 20, 1996. See also: Diamond W. H. & Diamond D.B., Overseas Press and Consultants, ed., *International Tax Treaties of All Nations* vol. XL Series B (New York: Oceana Publications, Inc., 1997) at 360-361.

In general, for the determination of residence to avoid double taxation, all the models define the term 'resident' as a person who, under the laws of a contracting state, is subject to tax in that state by reason of his/her domicile, residence, place of management, or any other criterion of a similar nature. However, the U.S. Model adds the criterion of 'citizenship' to determine the 'resident' issue. It is important to examine why the U.S. Model has an additional criterion.

Firstly, 'citizenship' is the fundamental basis for imposition of U.S. tax, and native born and naturalized U.S. citizens are the same for tax purposes without drawing general distinction. As stated in Section 1 of the United States International Revenue Code:

II. Persons and income subject to tax, Citizens, generally, Sole fact of taxpayer's American citizenship is sufficient basis for imposition of tax by Congress, and no basis exists for drawing general distinction for tax purposes between native born and naturalized citizen of United States, because when latter accepts protection of United States, available to all citizens, he simultaneously accepts same obligations which bind native born citizens.¹⁰⁵

Secondly, this criterion is included for the purpose of preventing tax avoidance.

Section 877 of the U.S. Internal Revenue Code states:

Expatriation to avoid tax. (a) In general. Every nonresident alien individual who at any time after March 8, 1965, and within the 10-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b)....(e) Burden of proof. If the Secretary establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result

¹⁰⁵ Edwards J.E., Riethmeier J.L. & Heit M.M., *United States Code Service*, vol. 26 (Lawyers Cooperative Publishing, 1996) at 38.

in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual.¹⁰⁶

That is to say, if a non-resident alien meets the three elements stipulated in the section, namely, whose loss of citizenship (1) is at any time after March 8, 1965, (2) is still within the 10-year period immediately preceding the close of the taxable year, (3) has for one of its principal purposes the avoidance of taxes (unless proven otherwise, with the burden of proof on the non-resident alien), he/she shall still be taxable regardless of his/her loss of U.S. citizenship.

Therefore, the United States will hold expatriated former citizens or long-term residents liable for United States taxes if the presumptive reason for their change of domicile was tax avoidance.¹⁰⁷ In many cases, it happens that U.S. citizens move to tax havens such as Bahamas or Bermuda with the principal purpose of tax avoidance. So, for practical purposes, the U.S. government, by employing 'citizenship' as the connecting factor to tax, is able to tax those of its citizens who move to a tax haven. Moreover, treaties make it easier for the U.S. government to enforce former citizens' tax obligation.

6.2.2 Comparison of the OECD Model and the U.N. Model:

¹⁰⁶ *Ibid.* at 584 - 585.

¹⁰⁷ See *supra* note 94 at 351.

The U.N. Model utilizes paragraph 1 of article 4 but omits the second sentence of the OECD Model which reads:

But this term [resident of a Contracting State] does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.¹⁰⁸

According to the commentary of the U.N. Model, the reason is:

'however , that the sentence could have a considerably broader impact. If one of the Contracting States taxed income solely when it arose from domestic sources, and did not tax income from foreign sources, the inclusion of the second sentence in any convention to which it was a party might result in all residents of that country being characterized as non-residents for the purposes of the convention and as a result being deprived of its benefits. The sentence was consequently omitted from the United Nations Model'.¹⁰⁹

For example, article 2 of the Taiwan Income Tax Law reads:

For any individual having income from sources in the Republic of China, consolidated income tax shall be levied in accordance with this law on his income derived from sources in the Republic of China.¹¹⁰

¹⁰⁸ Diamond W.H., Diamond D.B., Overseas Press and Consultants, ed., *International Tax Treaties Of All Nations* vol. XXV Series B (New York: Oceana Publications, Inc., 1992) at 546-547.

¹⁰⁹ See *supra* note 5 at 2055-2056.

¹¹⁰ Industrial Development and Investment Center, *Income Tax Law (in Taiwan)*, trans. Lee & Li Attorneys-at-law (Taipei: Industrial Development and Investment Center, MOEA, 1995) at 1.

Taiwan only imposes tax on the individual (who is qualified as a Taiwan resident for tax purposes)¹¹¹ on his/her income from domestic sources, not on foreign-source income. The potential impact mentioned in the U.N. Commentary would occur in this situation and Taiwan would be deprived of tax benefits.

6.2.3 Comparison of the U.S. Model and the U.N. Model

The U.S. Model has more criteria to determine 'the resident of a Contracting State', for example, the criteria of 'citizenship' and 'place of incorporation' (in business income tax), compared to the U.N. Model.

The U.S. Model adds subparagraphs (a)-(d) in paragraph 1 of article 4 to clarify the concept of residence:

(1) Subparagraph (a) provides that 'a person who is liable to tax in a Contracting State only in respect of income from sources within that State will not be treated as a resident of that Contracting State'¹¹² for purpose of the U.S. Model. With respect to this, the U.S. Model follows the OECD Model, which favours the capital exporting nations.

¹¹¹ This conclusion comes from comparative analysis of the two paragraphs in article 2 of the Income Tax Law of Taiwan which states that '[1] For any individual having income from sources in the Republic of China, consolidated income tax shall be levied in accordance with this Law on his [her] income derived from sources in the Republic of China. [2] Unless otherwise provided in this Law, in the case of an individual who is a *nonresident* in the Republic of China but who has derived income from sources in the Republic of China, income tax payable by him [her] on all such income shall be withheld and paid at the respective sources'. In short, the second paragraph is applied to non-resident situations, and the first paragraph to resident's. *Ibid.* See also: Chang J.D., *Income Tax Law* (in Taiwan) (Taipei: Wu-nan Publishing Company, 1996) at 29. (In Chinese).

¹¹² See *supra* note 94 at 423.

(2) Subparagraph (b) provides that 'certain tax-exempt entities such as pension funds and charitable organizations will be regarded as residents regardless of whether they are generally liable for income tax in the State where they are established'.¹¹³ The inclusion of this provision is intended to clarify the generally accepted practice of treating an entity that would be liable for tax as a resident under the internal law of a state, except for specific exemptions from tax as a resident of that State for purposes of paragraph 1.

(3) Subparagraph (c) specifies that 'a qualified governmental entity is to be treated as a resident of that State'.¹¹⁴ The purpose of including the rule in the U.S. Model is to make this understanding explicit¹¹⁵.

(4) Subparagraph (d) addresses 'special problems presented by fiscally transparent entities such as partnerships and certain estates and trusts that are not subject to tax at the entity level'.¹¹⁶ Subparagraph (d) provides that an item of income derived through such fiscally transparent entities will be considered to be derived by a resident of a Contracting State if the resident is treated under the taxation law of the State where he is resident as deriving the item of income.

These subparagraphs are not included in the U.N. Model.¹¹⁷

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.*

¹¹⁶ *Ibid.*

¹¹⁷ See *supra* note 94 at 422-426.

Aside from that, in paragraph 3, the U.S. Model seeks to settle dual-residence issues for companies. Under paragraph 3, the residence of such a company will be in the Contracting State under the laws of which it is created or organized. Dual residents other than individuals or companies such as trusts or estates are addressed by paragraph 4 of the U.S. Model. If such a person is, under the rules of paragraph 1, resident in both contracting states, the competent authorities shall seek to determine a single state of residence for that person for purpose of the U.S. Model. There are no similar provisions included in the U.N. Model for such situations.

6.3 Comparison of Treatment of Capital in the Three Model Treaties

6.3.1 OECD Model : favours the capital exporting nations

Article 4 of the OECD model, with respect to the individual's tax liability in a contracting state, does not include any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein. That is to say, the country of residence of an investor is often favoured over the country in which the taxpayer has placed his/her investment funds. To put it plainly, the OECD Model favours the capital exporting nations.

6.3.2 U.S. Model : favours the capital exporting nations

Basically, article 4 of the U.S. Model reproduces article 4 of the OECD Model. In other words, the U.S. Model also favours the capital exporting nations.

6.3.3 U.N. Model : favours the capital importing nations

Article 4 of the U.N. Model basically reproduced the OECD Model but with one substantive change, namely the deletion of the second sentence of paragraph 1 which reads: '[B]ut this term [resident of a Contracting State] does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein'. That is to say, the country of revenue source where the taxpayer has placed his/her investment funds is often favoured over the country of residence of an investor.

One commentator has noted that '[D]eveloping countries have not found that the OECD models are suitable to their tax policies, as, from their perspective, the OECD overemphasizes the right to tax in the state of residence and does not give enough room to the state of [revenue] source to impose taxation. This led to the publication by the United Nations of its model treaty in 1984'.¹¹⁸ It can be concluded that the U.N. Model is biased more to the benefit of capital importing nations.

6.4 Hypothetical Canada-Taiwan Tax Treaty (Agreement) -- What Model to follow?

¹¹⁸ Ward D. A., "Canada's Tax Treaties" (1995) 43 Canadian Tax Journal 1719 at 1720.

Relative to Taiwan, Canada is an immigrant-accepting¹¹⁹ and capital importing country¹²⁰. The continuous flow of capital from Taiwan to Canada has made Taiwan the nation exporting capital to Canada. The business immigration program in Canada, introduced 10 years ago, was designed to realize the economic goals of immigration policy and includes three business classes, composed of entrepreneurs, investors, and the self-employed.¹²¹ Under the terms of the investor program, according to Statistics Canada, the

¹¹⁹ The number of Taiwanese Immigrants: before 1961: 40, 1961-1970: 1320, 1971-1980: 4515, 1981-1990: 11275, 1991-1996: 32140. In addition, up to 1986, the population was 7210, and up to 1991, it was 17770, while up to 1996 the whole population increased up to 49290. The increasing number of Taiwanese immigrants illustrates that more and more Taiwanese emigrants choose Canada as their favoured new home. see: Statistic Canada, Nation Services Edition 1, Census 1996, 1997. (CD ROM). In addition, there are more and more Taiwanese immigrants to Canada: for example, in recent years, the numbers of the Taiwanese Immigrants are: 7411 (in 1994), 7691 (in 1995), and 13165 (in 1996). see: Citizenship and Immigration Canada, "Immigration - Top Ten Source Countries", Facts and Figures 1996, at 8.

¹²⁰ The capital flows between Canada and Taiwan in the last 7 years, provided by the statistics, are: in 1990, Canadian exports 788 (CND\$ million), imports 2,109 (balance: -1320); in 1991, Canadian exports 1,049, imports 2,212 (balance: -1162); in 1992, Canadian exports 953, imports 2,470 (balance: -1517); in 1993, Canadian exports 1,012, imports 2,625 (balance: -1613); in 1994, Canadian exports 1,706, imports 2,780 (balance: -1,074); in 1995, Canadian exports 2,180, imports 2,792 (balance: -612); in 1996, Canadian exports 1,847, imports 2,863 (balance: -1016). See *supra* note 20 at 6. See also: section 3.4 in this chapter.

¹²¹ Three business immigrant categories, namely, entrepreneurs, investors, and self-employed persons, make up Canada's business immigration program. The definitions of and different criteria for each of the three business immigrant categories are provided in section 6 of the *Immigration Act*.

(1) Entrepreneurs: the entrepreneur category is for those who wish to actively manage a business in Canada. To immigrate as an entrepreneur, a person must be able to demonstrate to immigration officials that he or she intends and has the ability to establish, purchase or make a substantial investment in a business in Canada that will make a significant contribution to the economy. The business must create or continue at least one job in Canada for a Canadian citizen or permanent resident other than the entrepreneur and dependents. The applicant must also intend and have the ability to provide active and ongoing participation in the management of the business.

(2) Investors: applicants under the investor program must make an investment through approved offerings. To be eligible as an investor, a person must have a proven track record in business and have accumulated a personal net worth of CND\$500,000 or more. Investors have the option of subscribing in any one of three investment levels: (a) Tier I: those provinces (including: Newfoundland, Nova Scotia, New Brunswick, Prince Edward Island, Manitoba, Saskatchewan, Alberta, Yukon and the Northwest Territories) with less than 10% of landed business immigrants, require a minimum investment of CND\$250,000 for a minimum holding period of five years; (b) Tier II: those provinces (including: British Columbia, Ontario and Quebec) with 10% or greater of landed business immigrants, require an investor to

investors shall invest for five years in small and medium-sized businesses -- the minimum investment required is \$ 350,000 (Canadian dollars) in B.C., Ontario, and Quebec, and the minimum investment in the other provinces is \$ 250,000. Therefore, it can be concluded that, with the minimum investment requirement, Canada, relative to Taiwan, is the capital importing country, and the capital flowing into Canada is increasing. According to the latest immigration overview provided by Citizenship and Immigration Canada, the numbers of principal applicants for business immigration from Taiwan were: 1154 (in 1994), 914 (in 1995), and 1181 (in 1996). The numbers of Taiwanese business immigrants and accompanying dependents in the recent years indicate that Taiwan is the second greatest source country of business immigration.¹²² With respect to the economic

have a net worth of CND\$500,000 and make a minimum investment of CND\$350,000 for a minimum holding period of five years; and (c) Tier III: in all provinces, there is also a CND\$500,000 investment, for a minimum holding period of five years, requiring an investor to have a net worth of CND\$700,000, which permits a guarantee by a third party.

(3) Self-Employed Persons: a self-employed person is an immigrant who intends and has the ability to establish or purchase a business in Canada that will create employment opportunity for that person, and will make a significant contribution to the economy, or the cultural or artistic life of Canada. Proven ability is shown by applicants who have previous business or cultural experience and sufficient financial resources.

See: section 6 of the *Immigration Act*. See also: Citizenship and Immigration Canada, *You asked about ... immigration and citizenship* (Ottawa: Public Affairs Branch, Citizenship and Immigration Canada, 1997) at 26 - 27.

The majority of business immigrants are entrepreneurs and investors. The number of self-employed remains small by comparison. Consequently, the impact of the entrepreneur and investor groups on the Canadian economy is much larger than that of the self-employed. For the details and the statistics from 1986-93, see: Kunin R. & Jones C.L., "Business Immigration to Canada" in DeVoretz D.J., ed., *Diminishing Returns -- The Economics of Canada's Recent Immigration Policy* (C.D. Howe Institute, Toronto; The Laurier Institution, Vancouver, 1995) at 269, 270. (table 1) (Appendix II). For the statistics from 1994-1996, see: Citizenship and Immigration Canada, "Immigration by Class" (1997) Facts and Figures 1996, at 3. (Appendix III)

¹²² Statistics on the amount of capital that the Taiwanese immigrants brought in are not available. However, it is also hard to estimate. It is not just a matter of using the minimum investment capital times the number of business immigrants from Taiwan only. The reasons are: (1) some Taiwanese business immigrants, even though they are required to invest the minimum capital in Canada, instead of bringing capital from overseas, may invest by taking a loan from a bank in Canada. In other words, the capital was not actually brought in by them. Nevertheless, in contrast, (2) some Taiwanese immigrants may bring in more capital than the minimum investment requirement.

power of Taiwanese immigrants, they not only contribute to the Canadian economy via investment, their job creation and their contribution to aggregate GDP, but also by their daily purchases in the local market.¹²³ One comment on the phenomenon of immigration flow is:

The United States and Canada are traditional immigration countries whose present-day cultures reflect their cosmopolitan heritages, and whose accomplishments as societies owe a great deal to immigrants contributions.¹²⁴

Because of the economic relations between Canada and Taiwan, it could be inferred that: both Canada and Taiwan would prefer to have the treaty follow the OECD Model. The reasons are as follows.

6.4.1 Canada is one of the OECD member countries

Canada is one of the OECD member countries and almost all of Canada's existing tax treaties are based on the provisions of one or other of the versions of the OECD Model. Thus, it is very likely that Canada would prefer to have the hypothetical treaty (or agreement) between Canada and Taiwan follow the OECD Model. The main purpose of the OECD Model is to provide a means of uniformly settling the most common problem arising in the field of international judicial double taxation, which is the imposition of identical (or comparable) taxes by two countries on the same taxpayer in respect of the

¹²³ See: Kunin R. & Jones C.L., "Business Immigration to Canada" in DeVoretz D.J., ed., *Diminishing Returns -- The Economics of Canada's Recent Immigration Policy* (C.D. Howe Institute, Toronto; The Laurier Institution, Vancouver, 1995) at 279, 275.

¹²⁴ Ucarer E.M. & Puchala D.J., ed., *Immigration Into Western Societies: Problems and policies* (London: Pinter, 1997) at 340.

same subject matter and for identical time periods. Judicial double taxation arises because most countries exercise jurisdiction to tax on at least two bases: source of income and residence of the taxpayer. OECD member countries are generally expected to conform to the Model Treaty when negotiating bilateral tax treaties. Canada is a member of the OECD and follows the model treaty as closely as possible¹²⁵. For example, in Canada, treaties are put into force by an implementing act which typically provides that the treaty will prevail over domestic law in the case of conflict.

6.4.2 OECD Model is the most widely-used model treaty

International judicial double taxation, and its harmful effects on the exchange of goods and services and movements of capital and persons, was first discussed in the 1963 Draft OECD Convention (i.e.: OECD Model). The existence of the Draft Convention has made it possible to facilitate bilateral negotiation between OECD Member countries and to reach a desirable harmonization between their bilateral conventions for the benefit of both taxpayers and national administrations. In addition, the impact of the Draft Convention of 1963 has extended outside the OECD areas; it has been used as a basic document of reference in negotiations between Member and non-Member countries and even between non-Member countries as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems.¹²⁶ Thus, it is more likely that Canada would choose to have the hypothetical treaty follow the OECD Model.

¹²⁵ Krishna V., *Canadian International Taxation*, ed. by Connell D.J., Baker A. & Easson A. (Toronto: Carswell, 1995) at 2-16, 2-17.

¹²⁶ See *supra* note 5 at 1521-1522.

Canada signed a treaty in 1980 with the Republic of Korea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income. The treaty between Canada and South Korea was based on the OECD Model, as are almost all Canada's other existing tax treaties. Since the economic situations of Taiwan and South Korea are very similar: they both are regarded as one of the "Four Small Asian Dragons", and, next to Hong Kong and Taiwan, South Korea is the third major source country with respect to business immigration to Canada, it could be inferred that the treaty (or an agreement) between Canada and Taiwan should follow the OECD Model as well.¹²⁷

Even though Canada might prefer to have the treaty follow the OECD Model, in the comparative analysis, it can also be concluded that Canada would accept that the treaty allow more revenue source based taxation as do the United States and Australia, which are also OECD member countries. For example, in treaties with developing countries, the United States, in the past, has been willing to accept substantially more revenue source based taxation than is foreseen in the model treaty.¹²⁸ In addition, Australia gives greater emphasis to revenue source taxation than the OECD Model given that it is a substantial net capital importer.¹²⁹ In this respect, since Canada and Australia are both the immigrant-

¹²⁷ Fong V., "Visa-for-dollars plan hits trouble, Fund Failures cost investors millions", *The Financial Post* (21, May 1991). With respect to the source countries of business immigrants to Canada, according to the latest statistics provided by Citizenship and Immigration Canada, (from 1994 to 1996), Hong Kong is ranked the top source country, Taiwan is the second source country, and the next one is South Korea. See: Appendix IV, Citizenship and Immigration Canada, "Business Immigration - Top Ten Source Countries" (1997) Facts and Figures 1996 at 55.

¹²⁸ See *supra* note 99 at 476-477.

¹²⁹ *Ibid.*

accepting and capital importing countries, it could be inferred that Canada would accept that the treaty provide more revenue source based taxation as does Australia.¹³⁰ The adjustment does not necessarily favour Taiwan. The details will be discussed in paragraph 7. Negotiation.

So, even though Canada, in this case, is the capital importing country, and the OECD Model treaty is not biased for Canada's benefit, with respect to the authority to tax provided in Article 4 of the OECD Model, it is still legitimate to infer that Canada would choose to have the treaty follow the OECD Model.

6.4.3 Taiwan would prefer to have the treaty follow the OECD Model

Taiwan is generally regarded by the international community as a developed or nearly developed country. Most of the developing countries usually take a different view of tax treaties. For example, some OECD member countries, which are developing countries, accept the first idea, namely, that the country of residence may eliminate double taxation either through a foreign tax credit or through exemptions for foreign source income. They have not, however, generally accepted the second idea, namely, reduction of the revenue source country's jurisdiction to tax. Indeed, some developing countries contend that jurisdiction to tax at revenue source should be exclusive and not shared.¹³¹

¹³⁰ *Ibid.*

¹³¹ See *supra* note 125 at 2-19.

To illustrate the reasons why Taiwan would prefer to have the treaty follow the OECD Model, some hypothetical scenarios are presented.

(1) Mr. X, a Taiwanese businessman, has 100 units of assets, 75 units are invested in Canada, in order to meet the minimum investment requirement in Canada as a business class immigrant, and 25 units are left in Taiwan. In this case, once Mr. X becomes a business class immigrant and therefore a tax resident in Canada, Canada gets the authority to tax him on the income of the 75 units of assets. Since Taiwan does not impose tax on foreign-source income, for maximum tax return, Taiwan would like to utilize the U.N. Model to collect tax on the revenue generated by the 25 units invested in Taiwan.

(2) Ms. Y, on the other hand, is a successful Taiwanese businesswoman, who does not want to leave Taiwan. However, she is quite willing to make investments outside of Taiwan. Of her 200 units of wealth, she has chosen to invest 100 units in Taiwan, and 100 units in Canada. In this situation, Taiwan, for maximum tax return, would like to choose to use the OECD Model which favours the capital exporting nation in order to collect tax on the revenue generated in Canada.

Thus, it is more to the advantage of Taiwan to utilize the OECD Model in the treaty with Canada. In the scenario provided above, Taiwan can get a net gain of 75 units of assets to subject to tax, if Taiwan chooses to follow the OECD Model instead of the U.N. Model.

[The result comes from the formula: 100 units (from Ms. Y, according to the OECD Model) minus 25 units (from Mr. X according to the U.N. Model.).]

(3) In another example, Mr. Z is a business class immigrant to Canada and a tax resident in Canada. He has 175 units in wealth: 75 units he invests in Canada, 35 units he leaves in Taiwan, and 65 units he invests in a third country A, with which Canada has already a tax treaty. Thus, the 100 units investment income would be regarded as producing world-wide income from Canada's perspective. With respect to the 65 units invested in country A, whether Canada or country A has the authority to tax the income depends on the treaty between Canada and country A. Similarly, the tax consequences of the 35 units depends on whether there is a treaty between Canada and Taiwan. If there is no treaty between Canada and Taiwan, due to the different connecting factors in their domestic laws, the income generated from the 35 units may be subjected to double tax.¹³²

To sum up the tax consequences on Mr. X, Ms. Y, and Mr. Z with respect to the tax treaty, if Taiwan chooses to utilize the U.N. Model, Taiwan will have 60 units subject to tax (25 units from Mr. X plus 35 units from Mr. Z), but lose 100 units subject to tax (from Ms. Y). More Taiwan people are like Ms. Y than Mr. X and Mr. Z. Thus, Taiwan, in order to get the maximum tax benefit, will likely insist on having the treaty follow the OECD Model.

¹³² The connecting factor to subject income to Canadian income tax is "residence", however, in Taiwan, it's domestic source of income. With respect to this, the income generated from the 35 units will be subjected to both Canadian and Taiwanese income tax.

Since the business status between Canada and Taiwan is almost equal¹³³, it can be concluded that it's not likely that Canada and Taiwan would insist on having the treaty follow the U.N. Model, since U.N. Model is designed to protect the tax benefits of the revenue source countries, which are generally the less developed countries, when they are negotiating a treaty with the developed countries.

Most countries tend to be consistent in using a specific model in order to enable the potential treaties be more predictable. In so doing, it also helps achieve uniformity in the treaties signed with all other countries. As most Canadian treaties follow the OECD Model, it could be inferred that Canada will be consistent in having the treaty between Canada and Taiwan follow the OECD Model, even though Canada would lose some tax revenue from the OECD Model.

7. Negotiation

Even though it is likely that both Canada and Taiwan would have the hypothetical treaty follow the OECD Model, negotiations of some deviations from the OECD Model are still to be expected. The possible negotiations and their respective concerns and benefits underlying the negotiation will now be discussed.

¹³³ See: section 3.4 in this chapter regarding the economic ties and flows between Canada and Taiwan.

As mentioned above, Canada might prefer to have the hypothetical Canada - Taiwan treaty follow the OECD Model. However, Canada might negotiate to adjust the treaty provisions to protect its revenue benefit. Canada might negotiate that the treaty be adjusted toward the U.N. Model, which is biased more to the benefit of capital importing nations in such a way that the tax rights of Canada are elevated.¹³⁴ A treaty to avoid double taxation is not only for the purpose of determining which Contracting State has the authority to tax but is also to clarify the different treatment of individuals and business entities.¹³⁵ In the Canada - South Korea treaty, Canada, in order to increase its tax rights, negotiated that the second sentence of Article 4, paragraph 1, of the OECD Model be omitted. This was done because the rest of the article is intended to apply only to persons who are resident in one of the Contracting States (in this case, South-Korea) and are liable in the other state (Canada) only on their income earned or gained from Canadian source. Canada, in order to obtain the authority to tax these people on their Canadian source income, negotiated that the treaty be adjusted more toward the U.N. Model. Moreover, it should not be concluded that the treaty intended to permit 'entities' that are taxable only on source-based income (in Canada) to claim benefits of the treaty as residents.¹³⁶ Even though the Canada - South Korea treaty was based on the OECD Model, Canada required that the second sentence of Article 4, paragraph 1 of the OECD Model be omitted in order not to let the benefit defined in the treaty be too broad.¹³⁷ Similarly, Canada might

¹³⁴ The reason can be referred back to 6.2.2 Comparison of the OECD Model and the U.N. Model.

¹³⁵ See *supra* note 125 at 11-28, 11-29.

¹³⁶ *Ibid.*

¹³⁷ *Ibid.*

negotiate to adjust the hypothetical Canada - Taiwan tax treaty from the provisions mentioned above in the OECD Model.

One comment on the Australia - Taiwan Treaty signed in May, 1996 says: '[M]ost of Australia's double-tax agreements follow the broad parameters of the OECD treaty. In some treaties with less developed countries, however, Australia has sometimes agreed to some provisions found in the U.N. Model treaty, partly in deference to the interests of those countries and partly because the government hopes the revenue costs of provisions similar to those in the U.N. treaty will be countered by political goodwill gains.'¹³⁸

Canada is of comparable international status to Australia for the purposes of a tax treaty, in that they are two of the major immigrant-accepting and capital importing countries.¹³⁹ In the light of this, Canada could be expected to act in the same manner as Australia in its treaties signed with less developed countries to gain some political goodwill.

However, Taiwan is a country exporting capital to Canada. To adjust the treaty between Canada and Taiwan more toward the U.N. Model would not necessarily be to the benefit of Taiwan. The reasons could be explored as follows.

¹³⁸ Krever, R. , "Australia-Taiwan tax treaty: pragmatism prevails" , (1997) 71, *The Australian Law Journal*) at 102.

¹³⁹ Canada's and Australia's political traditions are similar. In addition, they both use the common law systems where precedent is a very important influence on the direction of treaties.

Generally, capital exporting countries (in this case, Taiwan) favour low (or nil) taxes imposed on interest, royalties or dividends by the revenue source country (in this case, Canada) to maximize the room for taxation by the country in which the recipient of these payments resides. Capital importing countries, on the other hand, generally seek high revenue source country taxation of interest, royalties, and dividends. Similarly, the capital exporting country favours long periods as the basis for finding that an operation constitutes a permanent establishment, while the capital importing country seeks shorter qualifying periods to enable the site country to tax profits from shorter term projects¹⁴⁰.

According to Appendix V¹⁴¹, in the Australian treaty with Taiwan, 'there are a number of interesting aspects due to negotiations and concessions between the two jurisdictions. Firstly, the period for a construction, installation or assembly project to be treated as a permanent establishment is six months, as prescribed by the U.N. Model and half that required by the OECD Model. It may be that the six-month period was a concession by Taiwan, as it is quite possible that there are more projects operated in Australia by Taiwan companies than vice versa'.¹⁴² Secondly, the Australia-Taiwan treaty provides for the

¹⁴⁰ See *supra* note 138 at 103.

¹⁴¹ Appendix V is the chart provided by the author of the article "Australia-Taiwan tax treaty: pragmatism prevails" mentioned in the previous footnote. The chart compares the provisions of the OECD Model, the U.N. Model and the Australian treaties with the People's Republic of China and with Taiwan with respect to the five key issues in the text. By analyzing this chart, it can be concluded that the Australia-Taiwan Tax Agreement basically followed the OECD Model, but was adjusted more toward the U.N. Model. For example, the time required for consultancy to be treated as a permanent establishment (PE), in the Australia-Taiwan Tax Agreement, is 120 days, which is even shorter than that of 180 days under the U.N. Model. On the contrary, under the OECD Model, there is no PE for consultancy services, which is to the benefit of capital exporting countries.

¹⁴² See *supra* note 138 at 103.

provision of consultancy services to be treated as a permanent establishment if the services are provided over a relatively short period of time (120 days) compared to the U.N. Model norm of 183 days, or compared to the OECD Model, which provides no permanent establishment provision for consultancy services at all.¹⁴³ Thirdly, the Australia- Taiwan treaty provides for higher than normal withholding tax rates with respect to dividends and royalties.¹⁴⁴ Generally, the above mentioned concessions were closer to the U.N. Model, and could be understood to provide more benefits to Australia than to Taiwan.

Canada and Australia are two of the favoured countries that the Taiwanese would choose to be their new homes. In addition, both Canada and Australia are capital importing countries. Therefore, both the countries are closely related to Taiwan in terms of the cultural, political and economic ties due to the immigration and trading factors. According to the precedent of the Australia-Taiwan treaty, it could reasonably be inferred that the concerns and benefits underlying the existing Australia - Taiwan treaty and the hypothetical Canada - Taiwan treaty should be very much alike. It is fair to predict that the treaty between Canada and Taiwan would be based on the OECD Model but would be adjusted toward the U.N. Model to be more beneficial to Canada.

8. Relative Strength of Canadian and Taiwanese Negotiation Positions

¹⁴³ *Ibid.* at 103.

¹⁴⁴ *Ibid.*

Capital flow has had much impact on economic, social, and political arenas in developed and developing countries. Tax consequences of the capital flow between Canada and Taiwan are not currently covered by a treaty. The situation needs to be dealt with at the bilateral level, in discussions and negotiations through foreign policy dialogues aimed at the conclusion of bilateral agreements covering exchange of information, uniformity of tax benefits, trade policy etc. Theoretically, a fair negotiation shall conform to the global standards while being adjusted to the special concerns between two Contracting States.

Due to different political concerns and economic benefits, there may also be a conflict. The conflict should be resolved by some degree of compromise and concessions. If more Taiwanese continue to be interested in investing, doing construction, installation or assembly projects, and consulting activities in Canada than vice versa, then the expected concessions will be more likely to benefit Canada than Taiwan. Thus, the investment by individuals from Taiwan will likely be more acceptable and have more access to the Canadian market. Consequently, Canada would be able to use access to the market as a vehicle to negotiate better benefits in the hypothetical treaty between Canada and Taiwan.

9. Conclusion

With the signing of the treaty, the double taxation problem could be solved. Those who are honestly fulfilling their obligations could thus get tax credits, and be entitled to the benefits provided in the tax treaty. Due to the exchange of information obligations of both

contracting states provided in a treaty, those who want to evade tax by taking advantages of the treaty gap between the two jurisdictions, will understandably be against the treaty. In short, the impact of this treaty is the enforcement of tax obligations between Canada and Taiwan, to achieve the equity principle of taxation.

Chapter V

CONCLUSION

The goal of writing this thesis is to explore the potential of having a tax treaty (or agreement) between Canada and Taiwan to avoid double taxation, given that a treaty is probably the most efficient mechanism to solve the problem. Double taxation should be avoided due to its harmful effects on the movement of capital and persons, the expansion of trade in goods and services, and because it seriously impedes the widening of economic relations.¹ Therefore, countries negotiate bilateral tax treaties to prevent double taxation. The focus of this thesis is on individual income tax issues, even though most provisions in a treaty are about corporate income tax. The reason is that I believe individual income tax is more important than it appears to be in tax treaties because in most countries the tax system relies heavily on individual income tax for revenues rather than corporate tax.

The thesis starts with discussion of how double taxation of individual income by Canada and Taiwan comes about, in order to identify the root of the double taxation problem. Due to the different connecting factors used by Canada and Taiwan to subject individuals to tax, the two jurisdictions both have the authority to impose tax on an individual on the same income, and thus double taxation occurs. In Taiwan, individual income tax will be imposed on the individual's income earned or gained in Taiwan (domestic source income);

¹ Paul R. McDaniel, *Colloquium on NAFTA and Tradition: Formulary Taxation in the North American Free Trade Zone*, 49 Tax L. Rev. at 699.

however, in Canada, the individual will be subject to tax on his/her worldwide income as long as he/she is regarded as resident in Canada.² Due to the lack of a treaty between Canada and Taiwan, an individual who is subjected to the domestic income tax laws of the two jurisdictions will end up paying tax on the same income in each jurisdiction. Comparative studies are made in chapter two, to distinguish between the two different connecting factors, the income source principle used in Taiwan and the residence principle used in Canada. The income source principle is contained in the Territorial System³, which means that anyone who stays in the territory, regardless of whether he/she holds citizenship of the country or is resident in it, shall be subject to tax.⁴ On the contrary, the resident principle is contained in the Personal Link System.⁵ The Personal Link System, with different criteria in determining the personal link, contains both the 'citizenship' (or 'nationality') and the 'residence' connecting factors.⁶ 'Citizenship' is used in the United States (U.S.) to identify the people liable to pay income tax in the U.S.. In this case, whoever holds citizenship of the country shall be subject to tax, regardless of whether

² For the income source principle used in Taiwan to subject individuals to income tax, see: Article 2 of the income tax law of Taiwan (the Republic of China). See also: Industrial Development and Investment Center, *Income Tax Law (in Taiwan)*, trans. Lee & Li Attorneys-at-law (Taipei: Industrial Development and Investment Center, MOEA, 1995) at 1.

For the resident principle used in Canada to subject individuals to income tax, see: subsection 2(1) of the *Act*. 'Residence' is the principal connecting factor used in Canada. Specifically, income tax liability in Canada is based on residence, in conjunction with source of income. Canadian residents are taxable on their worldwide income, and non-residents on income derived from sources in Canada. For non-Canadian residents' tax liability, see: section 2(3) of the *Act*.

³ Wang J.S., *Taxation Law (in Taiwan)* (Taipei: Wen-sheng Publishing Company, 1996) at 39. (In Chinese). See also: Chang J.D., *Income Tax Law (in Taiwan)* (Taipei: Wu-nan Publishing Company, 1996) at 20, 29. (In Chinese).

⁴ *Ibid.*

⁵ *Ibid.*

⁶ *Ibid.*

he/she is a resident in the country.⁷ Residence is the principal connecting factor which is used for Canadian income tax. The residence connecting factor will subject the individual to tax by determining whether he/she is resident of that country, in accordance with the country's income tax law. The purpose of making the comparative analysis of the Personal Link System and the Territorial System is to get a whole picture of the tax systems in both Canada and in Taiwan, and to enhance understanding of the double taxation problem between the two jurisdictions.

The Foreign Reporting Rules highlight the dilemma of Taiwanese immigrants, which is whether to stay in Canada to keep their right to permanent residency, or to leave to avoid Canada's high tax rates and the double taxation problem between Canada and Taiwan. Since the *Rules* were incorporated in the *Act* in 1997, they have been affecting many immigrants' decision about whether to stay in Canada or to leave. Under the *Act*, all Canadian residents are required to disclose specific categories of offshore properties -- both tangible and intangible property must be declared, including shares in a non-resident corporation, interests in a non-resident trust or partnership, and indebtedness owned by a non-resident person, if their respective original costs exceeded CND\$100,000.⁸ Canadian

⁷ See: section 1 of the United States International Revenue Code. However, the exclusive adoption of the Personal Link System is rare. In the U.S., a combination of the two systems (the Personal Link System and the Territorial System) is utilized. In other words, in the U.S., citizenship is the principal connecting factor for tax purposes and residence is another major connecting factor. See: Ault H.J., *Comparative Income Taxation: A Structural Analysis* (Den Haag, the Netherlands: Kluwer Law International, 1997) at 137. Specifically, both U.S. citizens and any individuals who are permanent residents in the U.S. will be taxed on their worldwide income. It can be concluded that the U.S. tax system is a blend of Personal Link System and Territorial System.

⁸ See: footnote 4 in chapter 3.

residents are required to use Form T1135 to file an information return with Revenue Canada reporting those foreign properties. With respect to offshore holdings, Canadian residents must also file information returns in three other circumstances: (1) when they own an interest in a foreign affiliate⁹ (using Form T1134); (2) when they transfer or loan property to a non-resident trust¹⁰ (using Form T1141) and (3) when they receive a distribution from a non-resident trust (using Form T1142).¹¹ As explained by Canada's Auditor-General Denis Desautels, the *Rules* require Canadian residents to report their foreign assets. Their purpose is to give Revenue Canada a more complete picture of taxpayers' offshore investments so it can verify their tax returns.¹² It can be concluded that Revenue Canada has established rules and will enforce them and look closely, for tax purposes, at the worldwide income of Canadian residents¹³, which, of course, includes immigrants.

The *Rules* were originally intended to commence on January 1, 1996. However, the time for reporting foreign assets has been extended again and again¹⁴, mainly due to the voices of those who oppose the *Rules*. Some commentators have noted that the *Rules* are inappropriate, and the problems include the following: (1) the foreign reporting rules are a

⁹ See: footnote 6 in chapter 3.

¹⁰ See: subsection 233.2 (4) of the *Act*.

¹¹ See: subsection 233.6 (1) of the *Act*. See also: footnote 8 in chapter 3.

¹² See: footnote 9 in chapter 3.

¹³ Hogg P.W. & Magee J.E., *Principles of Canadian Income Tax Law* (Ontario: Carswell, 1997) at 112.

¹⁴ See: footnote 5 in chapter 3.

violation of privacy¹⁵; (2) they are a forerunner of a wealth tax¹⁶; (3) they unfairly target wealthy new Canadians and drive wealthy immigrants out of Canada¹⁷; (4) the \$100,000 limit is too low; it discourages foreign investors.¹⁸ It has been suggested that an alternative should be sought to improve compliance and increase revenue.¹⁹

From my perspective, the *Rules* are not a cure all for tax evasion. The *Rules* are aimed to prevent Canadian residents from evading tax.²⁰ In other words, Revenue Canada's main aim is to stop the flow of billions of dollars each year from Canadian residents and large Canadian corporations into overseas tax havens. However, one commentator has noted that, then Revenue Minister Jane Stewart was probably being excessively optimistic in claiming that '[w]e will make sure that all Canadians report income earned outside the country'.²¹ This is especially true 'if one avoids investing in countries, or in the type of assets, where automatic exchanges of information between tax authorities make it difficult to conceal such income, then tax evasion becomes relatively easy'.²² Besides, in countries where there are strict bank secrecy laws, the goal of the *Rules* is hard to attain.

¹⁵ See: subsection 2.1.1 in chapter 3.

¹⁶ See: subsection 2.1.2 in chapter 3.

¹⁷ See: subsection 2.1.3 in chapter 3.

¹⁸ See: subsection 2.1.4 in chapter 3.

¹⁹ See: subsection 2.1.5 in chapter 3.

²⁰ See: footnote 28 in chapter 3.

²¹ See: footnote 57 in chapter 3.

²² *Ibid.*

Even though the *Rules* are mainly aimed to prevent Canadian residents from evading tax, according to the recent reports²³, many Asians, especially immigrants believe they are being targeted and decide to leave Canada.²⁴ In some provinces, like B.C. and Ontario, where immigrants have made a positive effect on the economy, the departure of the investor and entrepreneurial immigrants has adversely affected these provinces' economies. Therefore, if the departure of wealthy immigrants and the rapid decline of the number of new immigrants coming to Canada are due to the *Rules*, some changes to the *Rules* are needed in order to change Canada's investment climate and the perceptions of foreign investors.²⁵ Without a full evaluation of the impact of the *Rules* on foreign investors and entrepreneurial immigrants, in the long run, Canada could turn out to lose revenue, even though the main goal of the *Rules* is to increase revenue.

The full enforcement of the *Rules* is very difficult. It requires Revenue Canada to hire more people to do checks and counterchecks in order to achieve the goal of the *Rules*, preventing Canadian residents from evading tax. The cost of doing so should be taken into consideration to make the measures more cost effective.

²³ See: footnotes 63, 65 in chapter 3.

²⁴ See: footnote 62 in chapter 3.

²⁵ See: footnote 61 in chapter 3.

Simplicity is one of the goals to achieve in a good tax system.²⁶ Simplicity in the tax system is desirable because it is important that taxpayers (individuals and corporations) understand the taxes that they pay and the tax implications of activities they may undertake. All tax measures should, as far as possible, be easy to understand and apply in order to facilitate compliance and enforcement.²⁷ According to the Special Release in the 1996 Budget, different forms are used for different foreign assets. Some commentators have noted that the reporting forms are horrendously complicated for taxpayers and their accountants. Revenue Canada will have to spend millions of dollars to organize an extremely complex system of checks and counterchecks. And yet, even when those checks are in place, they will not end tax evasion.²⁸ It can be concluded that the reporting forms are too complicated and need to be changed, in order to enhance compliance with the *Rules* and meet the requirement of simplicity in a good tax system.

Chapter three continues the discussion of the tax consequences for some immigrants, who are considered to be permanent residents, and, how their tax resident status relates to their permanent resident status in the *Immigration Act* and their application for Canadian citizenship in accordance with the *Citizenship Act*. The concept of tax residence under the *Act* and the concept of permanent residence under the *Immigration Act* are not the same,²⁹

²⁶ See: footnote 66 in chapter 3.

²⁷ *Ibid.*

²⁸ See: footnote 68 in chapter 3.

²⁹ See: footnote 73 in chapter 3.

but, in some situations, affect each other. For example, those immigrants who have not yet obtained citizenship of Canada may, for tax purposes, effectively choose to surrender their right to permanent residency in Canada pursuant to section 24 of the *Immigration Act*³⁰, even though they are not required to do so to become non-tax-residents.

Some immigrants are at risk of losing their permanent resident status. The reasons vary from one case to another -- some are for tax purposes, others, as reported, are to avoid the requirement of disclosing their foreign assets.³¹ Others lose residency due to the difficulty of meeting the residency requirement, either for business purposes or for employment reasons. Thus, there arises the issue of 'whether losing permanent resident status also means losing Canadian citizenship?', which is of concern to many permanent residents. Generally speaking, failure to live in Canada for more than 183 days, without satisfactory reasons, by a permanent resident will cause him/her to lose his/her status under section 24 of the *Immigration Act*. This is a big concern for immigrants who want to obtain Canadian citizenship.

The intertwined concepts of tax residence in the *Act*, permanent residence in the *Immigration Act*, and their relations to obtaining/losing Canadian citizenship can be analyzed as follows. A permanent resident, before he/she obtains his/her Citizenship, is not required to surrender his/her right to permanent residency to become a non-tax-

³⁰ See: footnote 74 in chapter 3.

³¹ See: section 2.1 in chapter 3.

resident from the *Act's* perspective. However if, in order to avoid tax, a permanent resident fails to live in Canada for at least 183 days in any one twelve month period without satisfactory reasons, he/she is very likely to lose his/her status under section 24 of the *Immigration Act*, and consequently, lose his/her opportunity to apply for Citizenship because he/she disrupts the Citizenship application procedure prescribed in the *Citizenship Act*. For practical purposes, a permanent resident, who wants to declare non residence for tax reasons, surrenders his/her right to permanent residency in Canada. Therefore, as far as the related provisions (in the *Act*, the *Immigration Act*, and the *Citizenship Act*) go, if a permanent resident, before he/she obtains Citizenship, declares non-residence for tax purposes and disrupts the procedure of the Citizenship application, he/she in reality loses both his/her permanent resident status and opportunity for citizenship.

I demonstrate in chapter three that those immigrants who choose to lose their permanent resident status for tax reasons, may still be subject to Canadian income tax. If an individual wants to become a non-resident for tax reasons, he/she can not stay in Canada for more than 183 days, or he/she will be caught by subsection 250(1) of the *Act* and deemed to be a tax resident and thus have to pay income tax on his/her worldwide income. Therefore, any individual who gave up his/her permanent resident status and declared non-residence, is still subject to Canadian income tax but only on amounts earned or produced from employment in Canada, business in Canada or dispositions of taxable Canadian property, under subsection 2(3) of the *Act*. In addition, the individual is also liable to Part III tax on interest, dividends, etc. in the *Act*, as illustrated in chapter two.

Chapter four explores the potential of having a treaty (or an agreement) between Canada and Taiwan to avoid double taxation. The possibility of having a tax agreement between Canada and Taiwan has been the concern of many Canadians as well as Taiwanese, particularly those who are involved in business and/or for immigration reasons. A treaty is probably the most efficient mechanism to solve the double taxation problem. The benefits of having a tax treaty are that, by employing the 'tie-breaker rules', a treaty determines which contracting state has the authority to tax and therefore provides a tax credit as a relief. This avoids double taxation.

However, a treaty can only be signed between nation states having international personalities. Most members of the international community, including Canada, do not formally recognize Taiwan as a sovereign state. Canada ceased diplomatic recognition of the 'Republic of China' (Taiwan) in 1970,³² which means that Canada only recognizes Taiwan as a province of mainland China under its 'one China policy'.³³ Due to Canada's non-recognition of Taiwan, the signing of a tax treaty (or an agreement) faces a political dilemma, that is how can a nation state enter into a treaty with a jurisdiction that it does not recognize as a country? In other words, the political dilemma is caused by the general non-recognition of Taiwan as a nation state by most countries in the world.

³² See: Canadian Trade Office in Taipei, *Taiwan -- A Briefing Book* (Taipei: Canadian Trade Office in Taipei, 1998) at 5.

³³ *Ibid.*

In response to the political dilemma, Taiwan has successfully developed its pragmatic foreign policy. In addition, due to the factual economic power of Taiwan,³⁴ most members of the international community, even though they do not formally recognize Taiwan as a sovereign state, maintain strong unofficial ties at the personal and trade/investment level with this economy.³⁵ The establishment and maintenance of private sector organizations to facilitate the bilateral trading relations can speak for itself. For example, Australia has 'The Australian Commerce and Industry Office' in Taipei, and New Zealand also has 'The New Zealand Commerce and Industry Office' in Taipei to improve their trade and investment flows with Taiwan. Likewise, the 'Taipei Economic and Cultural Offices' are established and maintained in those countries to serve the same purposes. It can be concluded that Taiwan's active pragmatic diplomacy reflects its desire for an international identity, which is its foremost foreign policy and is derived from its economic power.³⁶

The bilateral economic relationship between Australia and Taiwan brought about the unique Australia-Taiwan Tax Agreement signed on May 29, 1996. More specifically, the Australia-Taiwan Tax Agreement was signed between two private sector organizations -- 'The Australian Commerce and Industry Office' and 'The Taipei Economic and Cultural

³⁴ Taiwan is one of Asia's economic dragons, enjoying an average 8.6% growth for three decades. Taiwan has transformed itself into the world's 19th largest economy with annual per capita income of US \$14,200 (PPP) in 1996. *Ibid.* at 4.

³⁵ *Ibid.*

³⁶ See: section 3.3 in chapter 4.

Office', instead of between two governments. The Australia-Taiwan Tax Agreement is the mechanism to attain the goal of improving their bilateral trade and investment relations.³⁷ The legal consequence of having the tax agreement is to protect the two-way flow of economic activities from punitive double taxation.³⁸ In order to avoid additional complex legal procedures to bring the unique Australia-Taiwan Tax Agreement into effect, both Houses in Australia allowed the agreement to go through the same debate and passage procedure, as used in other tax agreements. Therefore, the Australia-Taiwan agreement was passed by the Parliament, and became a part of the International Tax Agreement Act 1953 and binding. In doing so, Australia successfully avoided the problem of its non-recognition of Taiwan.

Since the Australia-Taiwan Tax Agreement has become binding, double taxation by the two countries is avoided. However, there arises an interesting question as to 'how does an agreement between two non-governmental bodies become law or a binding treaty on the tax authorities of Australia and Taiwan'. Since the Australia-Taiwan Tax Agreement was passed by the Parliament of Australia, and is part of the law (the International Tax Agreement Act 1953), it is a binding agreement and the original signatories to the agreement became irrelevant. That is to say, once the Australia-Taiwan Tax Agreement is incorporated into a law (the International Tax Agreements Act 1953), it takes effect and it does not matter who signed the agreement originally, in this case, two private sector

³⁷ See: footnotes 70, 71 in chapter 4.

³⁸ *Ibid.*

organizations not governments. By doing so, Australia intelligently upheld its one-China policy, and successfully resolved the technical problem of 'how can an agreement between two non-governmental bodies become law or a binding treaty on the tax authorities of Australia and Taiwan'.

Australia and Canada are very similar in that politically they do not recognize Taiwan as a state³⁹, but economically, Canada, like Australia, has strong and continuing economic relationship with Taiwan. According to a report, 'Taiwan is Canada's 9th largest trading partner; Canada is Taiwan's 13th largest market'.⁴⁰ It can be concluded that the Australia-Taiwan Tax Agreement can be a precedent for the potential Canada-Taiwan Tax Agreement. Following the Australia-Taiwan Tax Agreement, the New Zealand-Taiwan and Vietnam-Taiwan tax agreements were signed respectively in Nov. 1996, and in Apr. 1998 in the same manner. These facts emphasize that the signing of a tax agreement between two private sector organizations is practical and acceptable to countries meaning to facilitate their bilateral economic ties with Taiwan.

By comparison of the three model treaties, namely, the OECD, the U.N. and the U.S. Models, it can be concluded that both Canada and Taiwan would prefer to have the potential Canada-Taiwan Tax Agreement follow the OECD Model. The reasons are as follows. Firstly, Canada is one of the OECD member countries and almost all of Canada's

³⁹ See: footnote 65 in chapter 4.

⁴⁰ See *supra* note 32 at 12.

existing tax treaties are based on the provisions of one or other of the versions of the OECD Model. Thus, it is very likely that Canada would prefer to have the hypothetical treaty (or agreement) between Canada and Taiwan follow the OECD Model. Secondly, OECD Model is the most widely-used model treaty. Therefore, it is more likely that Canada would choose to have the hypothetical treaty follow the OECD Model. On the other hand, Taiwan would also prefer to have the hypothetical treaty follow the OECD Model, since Taiwan is a country exporting capital to Canada⁴¹ and the OECD Model is in favour of the capital exporting countries.

However, Canada might negotiate that the treaty between Canada and Taiwan be adjusted toward the U.N. Model, which is biased more to the benefit of capital importing nations in such a way that the tax rights of Canada are elevated. Since Taiwan is a country exporting capital to Canada, to adjust the treaty between Canada and Taiwan more toward the U.N. Model would not necessarily be to the benefit of Taiwan. Due to different political concerns and economic benefits between Canada and Taiwan, there may exist a conflict. The conflict should be resolved by some degree of compromise and concessions. Theoretically, a fair negotiation should conform to the global standards while being adjusted to the special concerns between two Contracting States. However, if more Taiwanese continue to be interested in investing in Canada than vice versa, then the expected concessions will be more likely to benefit Canada than Taiwan. Thus, investment by individuals from Taiwan will likely be more acceptable and have more

⁴¹ According to CTOT's report, 'Canada-Taiwan trade has grown steadily, reaching close to CAD [Canadian Dollars] \$4.6 billion in 1996. Taiwan's surplus is approximately CAD\$ 800 million'. See *supra* note 32 at 5.

access to the Canadian market. Consequently, Canada would be able to use access to the market as a vehicle to negotiate better benefits in the hypothetical treaty between Canada and Taiwan.

The conclusion of this thesis is that, despite the political dilemma, the signing of the hypothetical Canada-Taiwan tax agreement is still possible, mainly due to pragmatic reasons. The benefits of signing this tax agreement include avoiding double taxation, preventing tax evasion, and facilitating the bilateral economic ties between Canada and Taiwan. However, if there is no tax agreement between Canada and Taiwan, Canada will be more likely to lose revenue than Taiwan, as Taiwan only imposes tax on income from Taiwan sources, while Canada imposes tax on its residents' worldwide income. In this light, theoretically, Canada should be more willing and more active in delivering the Canada-Taiwan Tax Agreement, regardless of its 'one China policy'.

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Appendix I: Definitions of the term 'resident' in the three model treaties

(i) OECD Model Treaty (Organization For Economic Co-operation And Development Model Convention, 1992) (hereinafter referred to as OECD Model):

'1. For the purposes of this Convention, the term "resident of a contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);
- (b) if the State in which he has his center of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
- (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the States of which he is a national;
- (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement¹

(ii) U.S. Model : (United States Model Income Tax Convention Of September 20, 1996) , (hereinafter referred to as U.S. Model):

'1. Except as provided in this paragraph, for the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by

¹ CCH Canadian Limited, *Canadian Tax Reports*, (Toronto: CCH Canadian Limited, 1993), at 37570-37571.

reason of his domicile residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature.

2. Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);
- (b) if the State in which he has his center of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
- (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the States of which he is a national;
- (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.²

(iii) U.N. Model Treaty (United Nations Model Convention, December 10 to 21, 1979) (hereinafter referred to as U.N. Model):

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

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);
- (b) if the State in which he has his center of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

² Diamond W.H., Diamond D.B., Overseas Press and Consultants, ed, *International Tax Treaties Of All Nations* Vol. XL Series B (New York: Oceana Publications, Inc., 1997) at 360-361.

- (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the States of which he is a national;
- (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement³.

³ Diamond W.H., Diamond D.B., Overseas Press and Consultants, ed, *International Tax Treaties Of All Nations* Vol. XXV Series B (New York: Oceana Publications, Inc., 1992) at 546-547.

Appendix II: Immigrants to Canada by Class, 1986-93

Table 1: Immigrants to Canada by Class, 1986-93

	1986	1987	1988	1989	1990	1991	1992	1993
Family	42,378	53,905	51,482	61,034	73,865	86,739	100,041	111,776
Refugee	6,615	7,666	8,937	10,370	11,634	18,465	28,853	22,109
Dependent								120
Designated	12,870	14,284	18,293	26,990	28,556	35,294	23,190	8,046
PDRCC								1
Asst. relatives	5,919	12,360	15,617	21,584	25,582	22,340	19,888	22,778
Live-in caregivers								2,955
Entrepreneur	1,683	2,332	2,957	3,135	3,070	2,473	3,868	4,199
Self-employed	514	738	824	653	612	611	859	1,077
Investor	5	88	250	535	1,005	1,254	2,268	3,054
Bus. dependent	5,353	8,001	11,135	13,288	13,862	12,832	21,152	24,318
Retired	1,839	2,677	3,181	3,573	3,549	4,244	5,481	7,724
Independent	22,759	51,276	500,007	51,693	54,006	47,758	47,545	46,379
Total	99,935	153,327	162,683	192,855	215,741	232,010	253,145	254,536
Business	2,202	3,158	4,031	4,323	4,687	4,338	6,995	8,330

Source: Unpublished data from Canada, Department of Citizenship and Immigration, Immigration Statistics Division (Ottawa, 1994)

Appendix III: Immigration By Class, 1994-96 (Business Class Immigrants)

Business Class		1994		1995		1996	
Entrepreneur	Principal Applicant	3,572	13.05%	2998	15.43%	3,174	14.1
Entrepreneur	Dependent	10,594	38.71%	8,416	43.32%	8,673	38.7
Self Employed	Principal Applicant	890	3.25%	952	4.90%	1,380	6.17
Self Employed	Dependent	1,846	6.75%	1,898	9.77%	2,975	13.3
Investor	Principal Applicant	2,562	9.36%	1,344	6.92%	1,597	7.14
Investor	Dependent	7,901	28.87%	3,820	19.66%	4,564	20.4
Total		27,365	100%	19,428	100%	22,363	100%

Abstracted from: Citizenship and Immigration Canada, "Immigration by Class" (1997)
Facts and Figures 1996 at 3.

Appendix IV: Business Immigration - Top Ten Source Countries

Business Immigration - Top Ten Source Countries									
Principal Applicants									
COUNTRY	Rank	1994 #	%	Rank	1995 #	%	Rank	1996 #	%
Hong Kong	1	3,122	44.45	1	1,778	33.59	1	2,308	37.5
Taiwan	2	1,154	16.43	2	914	17.26	2	1,181	19.2
Korea South	3	390	5.55	3	525	9.92	3	427	6.94
China-mainland	16	79	1.12	6	141	2.66	4	215	3.5
Germany W.	4	165	2.35	4	189	3.57	5	185	3.01
Iran	14	92	1.31	8	109	2.06	6	168	2.73
Pakistan	15	86	1.22	17	61	1.15	7	147	2.39
Switzerland	17	75	1.07	7	120	2.27	8	138	2.24
Netherlands	21	40	0.57	16	64	1.21	9	122	1.98
United Kingdom	10	111	1.58	11	95	1.79	10	111	1.8
Kuwait	11	111	1.58	5	150	2.83	11	95	1.54
Jordan	9	114	1.62	19	48	0.91	15	58	0.94
Saudi Arabia	5	139	1.98	9	102	1.93	17	55	0.89
Arab Emirates	7	133	1.89	10	96	1.81	18	51	0.83
Egypt	8	120	1.71	14	71	1.34	19	48	0.78
Philippines Rep. Of The	6	138	1.96	25	22	0.42	30	17	0.28
Total for Top Ten Only	-	5,586	79.53	-	4,124	77.9	-	5,002	81.3
Total Other Countries	-	1,438	20.47	-	1,170	22.1	-	1,149	18.6
Total		7,024			5,294			6,151	

Principal Applicants and Dependents									
COUNTRY	Rank	1994 #	%	Rank	1995 #	%	Rank	1996 #	%
Hong Kong	1	11,921	43.56	1	6,298	32.42	1	8,163	36.5
Taiwan	2	4,706	17.2	2	3,520	18.12	2	4,441	19.8
Korea South	3	1,567	5.73	3	1,992	10.25	3	1,662	7.43
China-mainland	16	246	0.9	9	422	2.17	4	684	3.06
Iran	13	379	1.38	8	434	2.23	5	662	2.96
Pakistan	14	360	1.32	13	294	1.51	6	645	2.88
Germany W.	10	479	1.75	5	626	3.22	7	610	2.73
Netherlands	20	159	0.58	16	223	1.15	8	493	2.2
Kuwait	9	502	1.83	4	675	3.47	9	405	1.81
Switzerland	17	228	0.83	12	307	1.58	10	396	1.77
United Kingdom	12	381	1.39	10	344	1.77	11	376	1.68
Saudi Arabia	4	731	2.67	6	497	2.56	12	286	1.28
Jordan	7	578	2.11	18	221	1.14	13	260	1.16
Arab Emirates	5	627	2.29	7	444	2.29	14	239	1.07
Egypt	8	541	1.98	11	324	1.67	18	195	0.87
Philippines Rep. Of The	6	608	2.22	22	95	0.49	26	80	0.36
Total for Top Ten Only	-	22,260	81.34	-	15,252	78.51	-	18,161	81.2
Total Other Countries	-	5,105	18.66	-	4,176	21.49	-	4,202	18.7
Total		27,365			19,428			22,363	

Source: Citizenship and Immigration Canada, "Business Immigration - Top Ten Source Countries" (1997) Facts and Figures 1996 at 55.

Appendix V: Five Key Issues compared in the treaties of the U.N. Model, the OECD Model, and the Australian treaties with U.S., P.R.C., and Taiwan

TAXATION

	U.N. Treaty	OECD Treaty	United States	PRC	Taiwan
Maximum source country tax rate on Interest	no maximum stated	10%	10%	10%	10%
Maximum source country tax rate on Dividends	no maximum stated	5% for 25% or greater share-holders; 15% for all other share-holders	15%	15% (But under domestic law, Australia imposes no withholding tax on franked dividends)	Australia can charge 10% on franked dividends and 15% on unfranked dividends; Taiwan can charge 10% for 25% or greater shareholders and 25% for all other share-holders
Maximum source country tax rate on Royalties	no maximum stated	no maximum stated	10%	10%	12.5%
Time for a project to be treated as a PE	6 months	12 months	12 months	6 months	6 months
Time for consultancy to be treated as a PE	period of activities in other country total 183 days or more over a 12-month period	no PE for consultancy services	no PE for consultancy services	period of activities in other country total 183 days or more over a 12 month period	period of activities in other country total 120 days or more over a 12-month period

Source: Krever R., "Australia-Taiwan tax treaty: pragmatism prevails", (1997) 71, The Australian Law Journal) at 102.