

FACULTY OF LAW

FINAL EXAMINATION – December 18, 2006

LAW 599:Y1 INTERNATIONAL TAXATION (Sommerfeldt)

Time Allotted: Two (2) Hours Plus Ten (10) Minutes Reading Time

Code Number: **DO NOT ENTER YOUR NAME ON ANY ANSWER SHEETS OR BOOKLETS.** A list will be circulated and your name is to be entered opposite a number on that sheet. That number will be your code number **FOR THIS EXAMINATION ONLY** and should be entered on the examination booklets in the space provided for surname. This will provide for anonymity during marking.

- Special Instructions:**
1. This examination paper contains 4 questions on 8 pages. Check to ensure that the examination paper is complete before starting.
 2. Answer ALL questions.
 3. Questions are NOT of equal value. Apportion your time wisely and intelligently. A suggested time allotment (based on a proportionate allocation of the available time among the potential marks) is:

<u>Question</u>	<u>Marks</u>	<u>Time</u>
Reading Time		10 minutes
Q. 1	45	60 minutes
Q. 2	25	34 minutes
Q. 3	10	13 minutes
Q. 4	<u>10</u>	<u>13 minutes</u>
	90 marks	130 minutes

4. This is an **OPEN-BOOK** examination.
5. Adhere to the time limitation imposed on this examination strictly. Failure to stop writing at the end of the examination may lead to a deduction of grades or a failure to accept the examination paper.
6. Cell phones, pagers, beepers and related equipment are strictly forbidden. These items must be turned off and stowed. Except by permission of the instructor, which will not routinely be given, laptop computers are not allowed in examinations.

7. Since it is very disruptive for those students finishing examinations while others are leaving the examination room and discussing the examination outside the examination door, it is requested that no individual leave the examination room during the last 15 minutes of the examination period.
8. Unless otherwise stated, all monetary amounts referred to in this examination paper are expressed in Canadian currency.
9. Unless otherwise stated, all statutory references in this examination paper are references to the *Income Tax Act* (Canada) (the “ITA”).
10. Support all your answers with references to applicable statutory provisions and jurisprudence.

VALUE QUESTION

45

1.

Managers ‘R’ Us Inc. (“MRU”) is a corporation incorporated under the laws of Delaware. Its sole officer, sole director and sole shareholder is Hank E. Doodle (“Hank”), who lives in New York City, New York and who is a resident of the United States for tax purposes.

The head office of MRU is located in New York City, New York. MRU is a resident of the United States for tax purposes.

MRU is a glorified temp agency, which carries on the business of providing temporary substitute mid-level managers to perform managerial functions on an *ad hoc* basis for clients whose own mid-level managers are on vacation, sick leave or temporary disability leave. MRU charges a monthly fee to its clients for the managerial services provided to those clients by MRU’s employees. As well, MRU requires its clients to reimburse MRU for the travel costs incurred by MRU’s employees in travelling to the location where they are to provide the temporary managerial services.

George W. Bust (“George”) is a trusted and experienced full-time employee of MRU. George, who is not married, lives in a condominium, which he owns, in Denver, Colorado. George is a resident of the United States for tax purposes. George is a citizen of both the United States and Canada. He is typically given assignments by MRU to work with MRU’s clients in the western United States and the three prairie provinces of Canada.

Whenever George works at a US location, MRU pays his salary in US currency. Whenever George works at a Canadian location,

MRU pays his salary in Canadian currency (in an appropriate amount to reflect the Canada-US exchange rate).

Hank and George are not related to one another. George deals at arm's length with MRU.

MRU has a small branch office located in Calgary, Alberta, which is staffed by a single employee, Olive Flame ("Olive"), whose job description includes business promotion, client development and assignment scheduling. In her ongoing efforts to find potential clients for MRU, Olive regularly places advertisements, touting MRU's services, in newspapers and trade magazines published and circulated in the three prairie provinces.

MRU treats the Calgary branch office as a separate profit centre, meaning that, for MRU's internal accounting purposes, MRU's Canadian-sourced revenues and MRU's Canadian-sourced expenses are allocated to the Calgary branch office of MRU.

Tar Sands Productions Ltd. ("TSP") was incorporated under, and continues to be governed by, the laws of Alberta. The sole officer, sole director and sole shareholder of TSP is Belinda Strongax ("Belinda"), who lives in Fort McMurray, Alberta and who is a resident of Canada for tax purposes. All of Belinda's duties and activities as a director of TSP are performed in Canada. TSP is a resident of Canada for tax purposes.

The head office and business premises of TSP are located in Fort McMurray, Alberta. TSP manufactures and distributes a variety of products used in the development of the tar sands in northeastern Alberta.

Hank and Belinda are not related to one another. George and Belinda are not related to one another. MRU and TSP deal with each other at arm's length.

Pete Black ("Pete") is a mid-level manager of TSP. In late February 2005, Pete sustained a serious injury while snowboarding, which resulted in his hospitalization for a month and his at-home convalescence for another four months. Shortly after Belinda learned of the seriousness of Pete's injuries, she telephoned Olive and arranged for TSP to engage MRU, under MRU's standard-form written contract, to provide temporary replacement managerial services to TSP from March 1, 2005 to July 31, 2005. On behalf of MRU, Olive assigned George to fulfill MRU's obligations under that contract.

On February 28, 2005, George flew from Denver, Colorado to Fort

McMurray, Alberta. The cost of George's airfare was C\$1,000, which was paid by MRU. MRU subsequently invoiced TSP to claim reimbursement of the airfare. In due course, TSP paid C\$1,000 to MRU in respect of the invoice.

After arriving in Fort McMurray, George lived in a rented suite in an apartment hotel in Fort McMurray. While in Fort McMurray, George performed the managerial duties normally performed by Pete. George occupied Pete's office in TSP's business premises and performed the same managerial functions for TSP that Pete would have performed if he had not been injured. George functioned in this capacity for five months, from March 1, 2005 to July 31, 2005.

While George was living in Fort McMurray, his condominium in Denver was unoccupied.

While George was working at TSP's premises, he continued to be an employee of MRU. (George did not become an employee of TSP.) George earned a salary of C\$8,000 per month for the period from March 1, 2005 to July 31, 2005. His monthly paycheques were processed and issued by the Calgary office of MRU. George deposited each paycheque in an account which he opened at the Fort McMurray branch of the Bank of Montreal.

As consideration for the managerial services provided by MRU, from March 1, 2005 to July 31, 2005, TSP was contractually obligated to pay a fee of C\$10,000 per month to MRU.

On August 1, 2005, having concluded his temporary assignment at the business premises of TSP, George caught a flight back to Denver. Back in Denver, George reoccupied his condominium.

The cost of George's airfare for the flight from Fort McMurray to Denver was C\$1,000, which MRU paid and subsequently invoiced to TSP. In due course, TSP paid the amount of the invoice to MRU.

While George was working in Fort McMurray, he spent all of his weekends and vacation time in Canada. In 2005, George did not spend any time in Canada before February 28, 2005 or after August 1, 2005.

In the context of the above facts, identify and discuss fully the Canadian federal income tax considerations and obligations which are relevant to MRU, TSP and George.

You need not discuss any tax considerations applicable to Hank, Olive, Belinda or Pete. It is not necessary to discuss any

considerations applicable to the actual computation of the income of TSP.

VALUE QUESTION

25

2.

Assume that you are a member in good standing of the Law Society of Alberta, with an office in a trendy district of Old Strathcona, overlooking the North Saskatchewan River Valley in Edmonton. Your practice focuses on Canadian income tax law.

You were just contacted by Tessa Ranger, the president of American Well Services Corporation (“Amco”), which is a corporation incorporated under the laws of Texas, with its head office in Houston, Texas and with all of its shareholders, directors and officers residing in Texas. Amco is a resident of the United States for income tax purposes.

Ms. Ranger explained that Amco is about to arrange for a wholly owned subsidiary, Canadian Well Services Company Ltd. (“Canco”), to be incorporated, likely under the *Canada Business Corporations Act* (the “CBCA”). Canco will be a resident of Canada for income tax purposes. Canco will have only one class of authorized and issued shares, which will be voting common shares. Canco will carry on the business of oilfield servicing in western Canada.

Ms. Ranger stated that Amco has sufficient financial resources to enable Amco to provide start-up capital to Canco, with the result that it will not be necessary for Canco to obtain bank financing.

Ms. Ranger requested your assistance in determining the optimum manner in which Amco should capitalize Canco. She explained that initially Canco will require capitalization of \$3,000,000. She would prefer that Canco have as much interest-bearing debt capitalization as possible (up to the full \$3,000,000, if you so advise), so as to benefit from the deduction of interest under paragraph 20(1)(c) of the ITA. However, she is not averse to having some (but not all) of Canco’s capital be in the form of equity, as distinct from debt.

Ms. Ranger indicated that the debt capitalization will likely be left in place for at least six years, unless you recommend that the debt be repaid over a shorter term.

Ms. Ranger also explained that, regardless of whether Canco is capitalized with debt or with a combination of debt and equity, it is anticipated that Canco will make regular distributions to Amco in respect of that capital (i.e., interest in respect of the debt and dividends in respect of the equity, if any).

Ms. Ranger requested that you provide her with a written explanation of the Canadian federal income tax considerations that are relevant to the capitalization of Canco and to the anticipated cross-border distributions in respect of that capital by Canco to Amco.

Ms. Ranger also inquired whether it would be best to incorporate Canco under the CBCA, or whether there would be any advantage or planning opportunities available if Canco were to be incorporated under the *Business Corporations Act* (Alberta).

Please write the explanation and advice that you would provide to Ms. Ranger.

You may confine your explanation and advice to tax and corporate-law principles which are relevant in a cross-border context.

VALUE QUESTION

10

3.

Michael Bitter (“Michael”) lives in Edmonton, Alberta and is a resident of Canada for tax purposes.

Michael is the sole officer, sole director and sole shareholder of Fidelity Holdings Inc. (“FHI”), which was incorporated under the laws of Alberta on January 17, 2006. Michael’s duties and activities as a director of FHI are performed in Canada. FHI’s head office and registered office are located in Edmonton, Alberta. FHI does not own any property and does not participate in any activities, except as will be described below. FHI has not continued into any other jurisdiction.

Betty Bitter (“Betty”) is Michael’s younger sister. Betty lives in Georgetown on Grand Cayman Island and is a resident of the Cayman Islands and a non-resident of Canada for tax purposes.

Worry-Free Trust Company (“WFT”) is a long-standing trust company incorporated and licensed under the laws of the Cayman Islands, with its head office and registered office in Georgetown on Grand Cayman Island. WFT is a resident of the Cayman Islands and a non-resident of Canada for tax purposes.

On April 1, 2006, Michael, in the capacity of settlor, settled the Michael Bitter Family Trust (the “Trust”) by delivering a gold coin to Betty, FHI and WFT, in the capacity of trustees (“the Trustees”). As well, Michael, as settlor, and Betty, FHI and

WFT, as trustees, signed a trust deed (the “Deed”) in respect of the Trust. The Deed provides that decisions concerning the Trust and the management, administration and property of the Trust may be made by a majority of the Trustees.

The Trustees arranged for the above-mentioned gold coin to be placed in a safety-deposit box in WFT’s business premises in Georgetown, Cayman Islands. WFT performs the day-to-day administrative functions in respect of the Trust.

On April 2, 2006, Michael paid to the Trustees the amount of C\$1,000,000, as a contribution to the Trust. The Trustees proceeded to invest that amount in a variety of blue-chip securities. Notwithstanding the terms of the Deed, Michael, in his capacity as the president of FHI, insisted on having the final say in respect of all major investment decisions.

The Trust has opened two bank accounts, one of which is at the main branch of the Royal Bank of Canada (“RBC”) in Edmonton, Alberta, and the other of which is at a branch of RBC in Georgetown, Cayman Islands. Both bank accounts require the signature of two Trustees, one of whom must be the president of FHI, to write cheques or to effect withdrawals.

The beneficiaries of the Trust are Michael’s children, all of whom are residents of Canada for tax purposes. Michael is very protective of his children. As well, he is strongly opinionated as to the magnitude of their financial needs.

Michael has a domineering personality, while Betty is rather timid.

Is FHI a resident of Canada for purposes of the ITA? Is the Trust a resident of Canada for purposes of the ITA? Explain your answer.

VALUE QUESTION

10

4.

Alberta Enterprises Inc. (“Altaco”) is a corporation incorporated in 2001 under the laws of Alberta. All of the shareholders, directors and officers of Altaco reside in Canada. Altaco is a resident of Canada for tax purposes.

Saskatchewan Investments Corporation (“Saskco”) is a corporation incorporated in 2002 under the laws of Saskatchewan.

All of the shareholders, directors and officers of Saskco reside in Canada. Saskco is a resident of Canada for tax purposes.

Northern Holdings Company (“Norco”) is a corporation incorporated in 2003 under the laws of the Northwest Territories. All of the directors and officers of Norco reside in Canada. Norco is a resident of Canada for tax purposes. Norco has only one class of authorized and issued shares.

Manitoba Properties Ltd. (“Manco”) is a corporation incorporated in 2004 under the laws of Manitoba. All of the directors and officers of Manco reside in Canada. Manco is a resident of Canada for tax purposes. Manco has only one class of authorized and issued shares.

Altaco owns all of the issued shares of Norco.

Altaco owns 50% of the issued shares of Manco. The other 50% of the issued shares of Manco are owned by Idaho Securities Inc. (“Idaco”), which is a corporation incorporated in 2000 under the laws of Idaho and which is a resident of the United States and a non-resident of Canada for tax purposes. All of the shareholders, directors and officers of Idaco reside in the United States.

Altaco, Saskco and Idaco are all unrelated corporations. Altaco, Saskco and Idaco deal with one another at arm’s length.

Bermuda Estates Ltd. (“Bermco”) is a corporation incorporated in 2005 under the laws of Bermuda. Bermco is a resident of Bermuda and a non-resident of Canada for tax purposes. Bermco has only one class of authorized and issued shares.

Saskco owns 56% of the issued shares of Bermco. Manco owns 30% of the issued shares of Bermco. Norco owns 10% of the issued shares of Bermco. Altaco owns 4% of the issued shares of Bermco.

For purposes of the ITA, is Bermco a foreign affiliate and/or a controlled foreign affiliate of Saskco and/or Altaco? Explain your answer.

TOTAL MARKS: 90

End of Examination