

**FACULTY OF LAW**

**FINAL EXAMINATION – December 17, 2005**

**LAW 599:Y2 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 7 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 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	20	27 minutes
Q. 3	15	20 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, lap top 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. 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. In this examination paper, the term "Canadian corporation" has the meaning assigned by subsection 89(1) of the ITA.
11. Support all answers with references to applicable statutory provisions and jurisprudence.

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VALUE	QUESTION
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1.

Assume that you are a member in good standing of the Law Society of Alberta, that you have an office in Edmonton, Alberta and that you practice Canadian federal income tax law, with an emphasis on the Canadian taxation of international transactions.

One day in December 2005 your telephone rings and, as you take the call, you discover that you're speaking to Ms. Annette Greenback, the chief financial officer of Eagle Properties Inc. ("EPI"), which is a corporation incorporated under the laws of Delaware, with its head office in Billings, Montana. All of the shareholders, directors and officers of EPI reside in the United States. EPI is a US taxpayer and a resident of the United States for US income tax purposes.

Ms. Greenback informs you that for the past seven years EPI has owned a vacant parcel of land not far from downtown Edmonton. EPI purchased the parcel of land in 1998 for \$7,000,000. EPI has recently accepted an offer from Beaver Acquisition Limited ("BAL"), a Canadian corporation, to purchase the parcel of land for \$10,000,000. The sale and purchase of the land will close on December 31, 2005, at which time EPI anticipates that BAL will pay the \$10,000,000 purchase price to EPI.

Thus far, EPI has not had any investments or activities in Canada, other than the ownership of the above-mentioned vacant parcel of

land. However, EPI has decided that, given the strong Alberta economy, EPI (or possibly a subsidiary) would like to undertake the construction of high-rise office towers in Edmonton. EPI has not yet decided whether the new construction activity will be undertaken by it, by an existing subsidiary of EPI or by a new subsidiary of EPI. EPI (or a subsidiary) will act as the general contractor in constructing office towers for various clients. The clients will own the office towers and the subjacent land. It is anticipated that each office tower will take at least two years to construct.

It is anticipated that whichever entity undertakes the new construction activity will require capitalization of \$6,000,000, either by way of debt or equity, or a combination thereof. EPI has the necessary financial resources to capitalize the entity undertaking the construction activity. Alternatively, EPI also has a good credit rating, such that it (or a subsidiary) could borrow up to \$6,000,000 from a commercial lender, either in Canada or outside Canada. EPI anticipates that, whatever the source of the capitalization, the funds would likely be required by the construction entity for approximately six to eight years.

It is anticipated that various administrative services will be provided by EPI's head office in Billings to whichever entity undertakes the new construction activity. A fee will likely be charged by the head office to the construction entity for such services. To the extent that the construction activity is profitable, the construction entity will repatriate (i.e., distribute), in one form or another, the profits to EPI's head office in the United States

Given its confidence in the Edmonton residential rental market, EPI has also made an offer to purchase a housing complex known as Sunset Village, which consists of four mid-size apartment buildings. EPI's management believes that it would be preferable to leverage EPI's investment; therefore, EPI will borrow 80% of the \$20,000,000 purchase price for Sunset Village. EPI has determined that it (rather than a subsidiary) will be the owner of Sunset Village.

Sunset Village is currently owned by Sundown Holdings Ltd. ("SHL"), a Canadian corporation, and is managed by Quick Care Corp. ("QCC"), which is a Canadian corporation and a property manager. QCC, as agent for SHL, has signed the residential leases with the tenants of Sunset Village. On behalf of SHL, QCC collects the rent, pays the expenses and remits any net profit to SHL. As part of the purchase arrangement, EPI will assume the contract between SHL and QCC, after which QCC will manage Sunset Village as the agent of EPI.

**Ms. Greenback requests that you provide her with a written summary of all Canadian federal income tax considerations that may be relevant to the transactions and proposals (including the various alternatives) set out above. In particular, Ms. Greenback would like you to explain the tax rules and principles that may be applicable to the contemplated transactions, proposals and alternatives.**

**Please write the summary which you would provide in respect of the above matter, being sure to include all relevant statutory and case citations.**

**You may confine your summary to tax and corporate principles which are applicable in a cross-border context.** In particular, you need not discuss whether the parcel of vacant land is capital property or inventory, nor is it necessary to discuss the replacement property rules. You may assume that the interest payable in respect of any borrowed money will be deductible under paragraph 20(1)(c) of the ITA.

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VALUE	QUESTION
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20	2. Canadian Enterprises Corp. (“Canco”) is a corporation incorporated in 1990 under the laws of Alberta. All of the shareholders, directors and officers of Canco reside in Canada.
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Canco owns 80% of the issued shares of American Enterprises Inc. (“Amco”), which is a corporation incorporated under the laws of Delaware. Amco is a US taxpayer and a resident of the United States for US income tax purposes. All of the directors and officers of Amco reside in the United States. Amco has only one class of authorized and issued shares.

Canco also owns 5% of the issued shares of Western Beef Importers Inc. (“Westco”), which is a corporation incorporated under the laws of Wyoming. Westco is a US taxpayer and a resident of the United States for US income tax purposes. All of the directors and officers of Westco reside in the United States. Westco has only one class of authorized and issued shares.

Amco owns 20% of the issued shares of Westco.

Maple Leaf Corporation (“Mapco”) owns 75% of the issued shares of Westco. Mapco was incorporated in 1988 under the laws of Ontario. All of the shareholders, directors and officers of Mapco reside in Canada.

Canco and Mapco are unrelated and deal with one another at arm's length.

In September 2003, Canco loaned \$2,000,000 to Westco on an interest-free basis. That loan is still outstanding. From the time the loan was advanced until now, Westco has used the borrowed money for the purpose of earning income from an active business (as defined in subsection 95(1) of the ITA).

The above-described shareholdings of Canco and Mapco in Amco and Westco have existed, without alteration, from 1992 until the present time.

Each of Canco, Mapco, Amco and Westco has a taxation year which begins on January 1 and ends on December 31.

**For purposes of the ITA, are Amco and Westco foreign affiliates and/or controlled foreign affiliates of Canco? Explain your answer.**

**Discuss any other Canadian federal income tax considerations that are relevant, in a cross-border context, to the above situation in respect of the 2004 taxation year.**

You may apply and discuss the provisions of the ITA as they currently exist. You may ignore any pending amendments to the ITA.

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VALUE	QUESTION
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15	3. Jack Vole was born and raised in Canada. He is a Canadian citizen. After serving as a fighter pilot in the Canadian armed forces for 10 years, Jack obtained employment as a commercial airline pilot with Air Canada. From 1990 to 2001, Jack and his wife, Jill Vole (who is also a Canadian citizen), lived in a house which they owned in Brampton, Ontario (a suburb of Toronto). For most of 2001 Jack owned a Ford Explorer and Jill owned a Honda Civic; both vehicles were registered in Ontario. Jack and Jill have no children.
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Jack generally flew on Air Canada flights originating, or ending, at Pearson International Airport in Toronto. He flew both domestic and international routes.

Having tired of both Canadian winters and Canadian taxes, in November 2001 Jack and Jill sold their house and furniture in Brampton and many of their other personal belongings. Jack sold the Ford Explorer. Jack and Jill closed all of their Canadian bank accounts, except one. They cancelled their health insurance under the

Ontario Health Insurance Plan and they terminated their memberships in their various social and recreational clubs in Ontario. In December 2001 Jack and Jill moved to Hamilton, Bermuda, where they leased (for a one-year term) and occupied a beach-front home. Jack advised his employer, Air Canada, of his new address.

Jack's usual pattern was to work for approximately two weeks and then to have a week or two off. During each two-week interval of flying, he would have time off (of varying duration) between flights. Throughout 2002, Jack commuted from Hamilton, Bermuda to Toronto, Ontario, where his assigned flights originated. Since airline regulations required Jack to be in Toronto at least one day before a scheduled flight, whenever he was temporarily in Toronto, he arranged to stay with his parents-in-law in their house, which was also located in Brampton, Ontario. In 2002 Jill visited her parents on four occasions, each visit lasting approximately one week. Whenever Jack and Jill were not using the Honda Civic, they parked it at Jill's parents' home in Brampton.

Whenever Jack returned to Toronto from an assigned flight, if he had only a day or two before his next flight, he would stay with his parents-in-law in Brampton. If he had three or more days between flights, he would return to Bermuda, where he would remain until it was time to go to Toronto for his next flight.

Jack and Jill joined a church congregation and a golf club in Bermuda. They also opened a joint bank account in Bermuda.

Jack's pay cheques from Air Canada were deposited automatically to the Canadian bank account which he had kept open.

In 2002, Jack spent 180 days of the year in Canada.

In late 2002, Jack and Jill obtained US green cards (i.e., they were admitted to the United States for permanent residence). Therefore, in December 2002, when the lease on their Bermuda home expired, Jack and Jill moved to Miami, Florida, where they purchased a condominium unit. Jack advised Air Canada of his change of address.

Shortly after their arrival in Miami, Jack and Jill purchased a Toyota Camry, which they kept in Florida. They also found a new church congregation and golf club in Miami to join. Jack and Jill soon learned that the US Internal Revenue Service considered them to be residents of the United States and to be US taxpayers.

Throughout 2003 and 2004, Jack commuted from Miami to Toronto to fulfill his employment duties with Air Canada. In 2003 and 2004, Jack's work schedule and commuting pattern were similar to his work

schedule and commuting pattern in 2002. As well, Jill continued to visit her parents in Brampton four times a year, with each visit lasting approximately one week. Jill always arranged her visits to coincide with periods when Jack was flying for an extended period of time. Jack did not, in any of the three years under review, spend any of his vacations or extended time off (i.e., the periods of time which were between flights and which were greater than two days) in Ontario. He always returned to Bermuda or Florida, as the case may be, for extended time off and for vacations.

In 2003, Jack was present in Canada for 190 days of the year. In 2004, Jack was present in Canada for 175 days of the year.

**Was Jack a resident of Canada, for purposes of the ITA, in each, or any, of the 2002, 2003 and 2004 taxation years? Explain your answer.**

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<b>VALUE</b>	<b>QUESTION</b>
<b>10</b>	<b>4. Discuss the principles which the Canadian courts apply in interpreting a bilateral tax treaty to which Canada is a party. Include in your answer a discussion of the international and domestic documents and factors which a Canadian court may consider as part of its interpretive analysis. Discuss the relative weight which should be given to each document or factor.</b>

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**TOTAL MARKS: 90**

**End of Examination**