Federal Court of Appeal Cour d'appel fédérale

CANADA

Date: 20101117

Dockets: A-419-09
A-420-09

Citation: 2010 FCA 309

CORAM: **NADON J.A.**
SHARLOW J.A.
STRATAS J.A.

Docket: A-419-09

BETWEEN:

ST. MICHAEL TRUST CORP.,
as Trustee of the FUNDY SETTLEMENT

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Docket: A-420-09

BETWEEN:

ST. MICHAEL TRUST CORP.,
as Trustee of the SUMMERSBY SETTLEMENT

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Ottawa, Ontario, on September 30, 2010.
Judgment delivered at Ottawa, Ontario, on November 17, 2010.

REASONS FOR JUDGMENT BY: SHARLOW J.A.

CONCURRED IN BY: NADON J.A.
STRATAS J.A.

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<u>REASONS FOR JUDGMENT</u>

<u>SHARLOW J.A.</u>

[1] St. Michael Trust Corp., in its capacity as the trustee of the Fundy Settlement and the Summersby Settlement (the “Trusts”), has been assessed under the *Income Tax Act*, R.S.C. 1985, c.

1 (5th Supp.) for the 2000 taxation year. The assessed tax arises from capital gains realized by the Trusts on the disposition of the shares of two Canadian corporations at a time when, according to the Crown, the Trusts were resident in Canada. St. Michael Trust Corp. appealed the assessments to the Tax Court of Canada. The appeals were dismissed by Justice Woods (2009 TCC 450). St. Michael Trust Corp. now appeals to this Court. For the reasons that follow, I have concluded that these appeals should be dismissed with costs.

Relevant provisions of the *Income Tax Act*

[2] Subsection 2(1) of the *Income Tax Act* imposes tax on the taxable income for a year of every person who is resident in Canada at any time in the year. By virtue of the formula in section 3 of the *Income Tax Act*, taxable income includes the taxable portion of any capital gain realized in the year. In 2000, the taxable portion of a capital gain was 2/3.

[3] By the combined operation of subsections 2(3) and 115(1) of the *Income Tax Act*, a person who is not resident in Canada is outside the scope of subsection 2(1) but nevertheless is subject to tax on certain Canadian source income, including the taxable portion of a capital gain realized by the person on the disposition of property that meets the definition of "taxable Canadian property", unless the property also meets the definition of "treaty-protected property" in subsection 248(1).

[4] Generally, property is treaty-protected if a capital gain realized on its disposition is exempt from Canadian income tax because of an international tax treaty to which Canada is a party. The exemption operates through subparagraph 110(1)(*f*)(i) of the *Income Tax Act* which provides that, in

computing taxable income, a person is entitled to a deduction equal to any amount that is included in taxable income but exempt from Canadian tax because of an international tax treaty.

[5] For purposes of the *Income Tax Act*, a taxpayer may be an individual, a corporation or a trust. Although a trust is not a person as a matter of law, the *Income Tax Act* treats the trust for income tax purposes as though it were an individual. Conceptually, the trust is embodied in the trustee as the person who generally has legal title to the trust property, and who has the powers and discretions granted by the trust documents and the law, concerning the trust property. It is the trustee who is required on behalf of the trust to comply with all filing and reporting requirements under the *Income Tax Act*, to whom all assessments and other official notifications are sent, who has the legal status to object to assessments and to appeal, and who is responsible for paying the tax debts of the trust. That is the result of subsections 104(1) and (2) of the *Income Tax Act*, which read in relevant part as follows:

104. (1) In this Act, a reference to a trust or estate (in this subdivision referred to as a "trust") shall, unless the context otherwise requires, be read to include a reference to the trustee, executor, administrator, liquidator of a succession, heir or other legal representative having ownership or control of the trust property …	104. (1) Dans la présente loi, la mention d'une fiducie ou d'une succession (appelées « fiducie » à la présente sous-section) vaut également mention, sauf indication contraire du contexte, du fiduciaire, de l'exécuteur testamentaire, de l'administrateur successoral, du liquidateur de succession, de l'héritier ou d'un autre représentant légal ayant la propriété ou le contrôle des biens de la fiducie.
…	[...]
(2) A trust shall, for the purposes of this Act, and without affecting the liability of the trustee or legal	(2) Pour l'application de la présente loi, et sans que l'assujettissement du fiduciaire ou des représentants légaux à

<table>
<tr><td>representative for that person's own income tax, be deemed to be in respect of the trust property an individual …</td><td>leur propre impôt sur le revenu en soit atteint, une fiducie est réputée être un particulier relativement aux biens de la fiducie …</td></tr>
</table>

[6] Subsection 94(1) of the *Income Tax Act* is a special provision relating to trusts that are not resident in Canada. Broadly speaking, it applies when certain conditions are met as to the identity of the beneficiaries of the trust (the "beneficiary test", paragraph 94(1)(*a*)) and the manner in which the trust has acquired property (the "contribution test", paragraph 94(1)(*b*)). Those two provisions read in relevant part as follows:

<table>
<tr><td>94. (1) Where,</td><td>94. (1) Lorsque :</td></tr>
<tr><td>(a) at any time in a taxation year of a trust that is not resident in Canada or that, but for paragraph 94(1)(c), would not be so resident, a person beneficially interested in the trust (in this section referred to as a "beneficiary") was</td><td>a) d'une part, à un moment donné d'une année d'imposition d'une fiducie qui ne réside pas au Canada, ou qui, sans l'alinéa c), n'y résiderait pas, une personne ayant un droit de bénéficiaire sur la fiducie (appelé un « bénéficiaire » au présent article) était :</td></tr>
<tr><td>(i) a person resident in Canada, …
and</td><td>(i) une personne résidant au Canada, …</td></tr>
<tr><td>(b) at any time in or before the taxation year of the trust,</td><td>b) d'autre part, à un moment donné avant la fin de l'année d'imposition de la fiducie :</td></tr>
<tr><td>(i) the trust … has … acquired property, directly or indirectly in any manner whatever, from</td><td>(i) soit la fiducie … a acquis des biens, directement ou indirectement, de quelque manière que ce soit … auprès :</td></tr>
<tr><td>(A) a particular person who</td><td>(A) ou bien d'une personne donnée qui remplit les conditions suivantes :</td></tr>
</table>

(I) was the beneficiary referred to in paragraph 94(1)(*a*), was related to that beneficiary or was the uncle, aunt, nephew or niece of that beneficiary, …	(I) elle était le bénéficiaire visé à l'alinéa *a*), elle était liée à ce bénéficiaire ou elle était l'oncle, la tante, le neveu ou la nièce de ce bénéficiaire, …
the following rules apply for that taxation year of the trust: …	les règles suivantes s'appliquent pour cette année d'imposition de la fiducie: …

[7] It is undisputed in this case that the beneficiary test is met for both Trusts because they both have beneficiaries who are resident in Canada.

[8] There is a dispute as to whether the contribution test is met in this case. The contribution test may be satisfied in a number of ways. For the purposes of this case it is enough to say that it would be met if the Trusts acquired property, directly or indirectly in any manner whatever, from a Canadian resident person who is either a beneficiary or a person related to a beneficiary.

[9] If the beneficiary and contribution tests are met, and the trust is a discretionary trust (as the Trusts are), then paragraph 94(1)(*c*) deems the trust to be a person resident in Canada for the purposes of Part I of the *Income Tax Act* and certain provisions in Part XIV imposing reporting requirements (sections 233.3 and 233.4). Part I of the *Income Tax Act* contains the main charging provisions of the *Income Tax Act*, including section 2, the provision that imposes on every person resident in Canada a tax on income from any source in the world. Paragraph 94(1)(*c*) reads in relevant part as follows:

(*c*) where the amount of the income or capital of the trust to be distributed at any time to any beneficiary of the trust depends on the exercise by any person of, or the failure by any person to exercise, any discretionary power,	*c*) lorsque le montant du revenu ou du capital de la fiducie à attribuer à un moment donné à un bénéficiaire de la fiducie est fonction de l'exercice ou de l'absence d'exercice, par une personne, d'un pouvoir discrétionnaire :
(i) the trust is deemed for the purposes of this Part and sections 233.3 and 233.4 to be a person resident in Canada no part of whose taxable income is exempt because of section 149 from tax under this Part and whose taxable income for the year is the amount, if any, by which the total of [rules for computing taxable income omitted] …	(i) la fiducie est réputée, pour l'application de la présente partie et des articles 233.3 et 233.4, être une personne résidant au Canada dont aucune partie du revenu imposable n'est exonérée, par l'effet de l'article 149, de l'impôt prévu à la présente partie et dont le revenu imposable pour l'année correspond à l'excédent éventuel de la somme des montants suivants [règles applicables au calcul du revenu imposable omises] …

[10] The remainder of paragraph 94(1)(*c*) sets out special rules for the computation of the taxable income of a trust to which section 94 applies. The rules are complex, but for the purposes of this case the parties agree that under paragraph 94(1)(*c*), the taxable income of a discretionary trust includes all income of the trust except income from an active business outside Canada.

[11] The assessments under appeal in this case are based in the alternative on the general anti-avoidance rule in section 245 of the *Income Tax Act*. Broadly speaking, subsection 245(2) may apply to justify an assessment, regardless of any other statutory provision, where a transaction is undertaken to avoid tax and the transaction is abusive within the meaning of subsection 245(4). Section 245 reads in relevant part as follows:

(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

(2) En cas d'opération d'évitement, les attributs fiscaux d'une personne doivent être déterminés de façon raisonnable dans les circonstances de façon à supprimer un avantage fiscal qui, sans le présent article, découlerait, directement ou indirectement, de cette opération ou d'une série d'opérations dont cette opération fait partie.

(3) An avoidance transaction means any transaction

(*a*) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or

(*b*) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

(3) L'opération d'évitement s'entend :

a) soit de l'opération dont, sans le présent article, découlerait, directement ou indirectement, un avantage fiscal, sauf s'il est raisonnable de considérer que l'opération est principalement effectuée pour des objets véritables — l'obtention de l'avantage fiscal n'étant pas considérée comme un objet véritable;

b) soit de l'opération qui fait partie d'une série d'opérations dont, sans le présent article, découlerait, directement ou indirectement, un avantage fiscal, sauf s'il est raisonnable de considérer que l'opération est principalement effectuée pour des objets véritables — l'obtention de l'avantage fiscal n'étant pas considérée comme un objet véritable.

(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(*a*) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of

(i) this Act,

(4) Le paragraphe (2) ne s'applique qu'à l'opération dont il est raisonnable de considérer, selon le cas :

a) qu'elle entraînerait, directement ou indirectement, s'il n'était pas tenu compte du présent article, un abus dans l'application des dispositions d'un ou de plusieurs des textes suivants :

(i) la présente loi,

(ii) the *Income Tax Regulations*,	(ii) le *Règlement de l'impôt sur le revenu*,
(iii) the *Income Tax Application Rules*,	(iii) les *Règles concernant l'application de l'impôt sur le revenu*,
(iv) a tax treaty, or	(iv) un traité fiscal,
(v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or	(v) tout autre texte législatif qui est utile soit pour le calcul d'un impôt ou de toute autre somme exigible ou remboursable sous le régime de la présente loi, soit pour la détermination de toute somme à prendre en compte dans ce calcul;
(*b*) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.	*b*) qu'elle entraînerait, directement ou indirectement, un abus dans l'application de ces dispositions compte non tenu du présent article lues dans leur ensemble.

Relevant provisions of the *Barbados Tax Treaty*

[12] The *Canada-Barbados Income Tax Agreement (1980)* (the Barbados Tax Treaty), formally titled "Agreement between Canada and Barbados for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital", was enacted as a federal law by S.C. 1980-81-82-83, c. 44, Part IX. For the purposes of these appeals, the following interpretive provisions in Article III (General Definitions) of the Barbados Tax Treaty are relevant:

1. In this Agreement, unless the context otherwise requires: …	1. Au sens du présent Accord, à moins que le contexte n'exige une interprétation différente : …
(c) the term "person" includes an individual, an estate, a trust, a company, a partnership and any other body of persons; …	c) le terme « personne » comprend les personnes physiques, les successions (estates), les fiducies (trusts), les sociétés, les sociétés de personnes

	(partnerships) et tous autres groupements de personnes; …
2. As regards the application of this Agreement by a Contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Agreement.	2. Pour l'application du présent Accord par un État contractant, toute expression qui n'est pas autrement définie a le sens qui lui est attribué par la législation dudit État régissant les impôts qui font l'objet du présent Accord, à moins que le contexte n'exige une interprétation différente.

[13] Broadly speaking, the Barbados Tax Treaty exempts the residents of one of the contracting states from income taxes imposed by the other on specified income and gains, subject to numerous conditions. For purposes of the Barbados Tax Treaty, residence is determined under Article IV (Fiscal Domicile), which reads in relevant part as follows:

1. For the purposes of this Agreement, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.	1. Au sens du présent Accord, l'expression « résident d'un État contractant » désigne toute personne qui, en vertu de la législation dudit État, est assujettie à l'impôt dans cet État en raison de son domicile, de sa résidence, de son siège de direction ou de tout autre critère de nature analogue, et les expressions « résident du Canada » et « résident de la Barbade » ont le sens correspondant.
…	…
3. Where, by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then the competent authorities of the Contracting States	3. Lorsque, selon la disposition du paragraphe 1, une personne autre qu'une personne physique est considérée comme résident de chacun des États contractants, les autorités

shall by mutual agreement endeavour to settle the question and to determine the mode of application of the Agreement to such person.	compétentes des États contractants s'efforceront d'un commun accord de trancher la question et de déterminer les modalités d'application du présent Accord à ladite personne.

[14] By virtue of paragraph 4 of Article XIV of the Barbados Tax Treaty a person (including a trust) that meets the treaty definition of "resident of Barbados" but not the treaty definition of "resident of Canada" is entitled to an exemption from Canadian income tax on any capital gain realized on the disposition of shares of a corporation (subject to exceptions that are not relevant to this case). Article XIV (Gains from the Alienation of Property) reads in relevant part as follows:

1. Gains from the alienation of movable property may be taxed in the Contracting State in which such property is situated.	1. Les gains provenant de l'aliénation de biens immobiliers sont imposables dans l'État contractant où ces biens sont situés.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State … may be taxed in the other State. …	2. Les gains provenant de l'aliénation de biens mobiliers faisant partie de l'actif d'un établissement stable qu'une entreprise d'un État contractant a dans l'autre État contractant…sont imposables dans cet autre État. …
3. (a) Gains from the alienation of shares of a company, the property of which consists principally of immovable property situated in a Contracting State, may be taxed in that State. …	3. a) Les gains provenant de l'aliénation d'actions d'une société dont les biens sont constitués principalement de biens immobiliers situés dans un État contractant sont imposables dans cet État. …
4. Gains from the alienation of any property, other than those mentioned in paragraphs 1, 2 and 3 may be taxed only in the Contracting State of which the alienator is a resident.	4. Les gains provenant de l'aliénation de tous biens autres que ceux qui sont mentionnés aux paragraphes 1, 2 et 3 ne sont imposables que dans l'État contractant dont le cédant est un résident.

Facts

[15] I summarize as follows the facts relating to the transactions underlying the assessments under appeal.

[16] PMPL Holdings Inc. ("PMPL") was incorporated in Canada in 1992 to hold the shares of two Canadian operating corporations, Progressive Moulded Products Inc. and Progressive Tools Limited. The PMPL corporate group was originally owned and controlled by Myron Garron and members of his family. In 1990, Mr. Andrew Dunin, who is not related to the Garron family, became involved with Progressive Moulded Products. He was promised the right to earn equity shares of PMPL, and in fact he contributed substantially to its financial success.

[17] By 1996, the common shares of PMPL were owned as to 50% by Mr. Dunin and as to 50% by a Canadian corporation, Garron Holdings Ltd. ("Garron Holdings"). The shares of Garron Holdings were owned by Myron Garron and his spouse Berna Garron, and a trust of which Mr. and Mrs. Garron were the trustees and their children and grandchildren were the beneficiaries. At all material times, Mr. Garron and his spouse and Mr. Dunin were resident in Canada.

[18] At some point early in 1998, a decision was made to change the ownership structure of PMPL. One objective of that change was to increase Mr. Dunin's share of PMPL in continued recognition of his contribution to its financial success. Another objective was to ensure that no Canadian tax would be payable on any capital gain that could result from an increase in the value of PMPL after the 1998 reorganization.

[19] The tax objective was intended to be achieved by attributing any post-reorganization increase in the value of PMPL to the common shares of a newly created corporation held by trusts that would not be resident in Canada but would, as residents of Barbados, be entitled to the benefit of the exemption from Canadian tax in paragraph 4 of Article XIV of the Barbados Tax Treaty.

[20] The plan to restructure the ownership of PMPL required that the existing common shares of PMPL be cancelled and replaced with three new classes of shares, as follows:

1000 Class A preference shares – the "Freeze Shares".

a. The Freeze Shares would be issued in exchange for the existing common shares. They would carry voting rights and be redeemable for an amount equal to the fair market value of the existing common shares immediately before the reorganization took effect, which at the time the parties agreed was $50 million. The Freeze Shares would not participate in dividends except on redemption, when dividends would be cumulative between the date of the request for redemption and the date of redemption.

100 Class B shares – the "Special Value Shares"

b. These shares would carry no voting rights or dividend entitlement. They would be retractable (that is, redeemable at the call of the holder) at an amount equal to 10% of the amount by which the fair market value of all shares of PMPL and Progressive Marketing, Inc. at the time of retraction exceeded $50

million. They would be issued to Mr. Dunin or a corporation controlled by him, so that the economic benefit of the retraction amount of the Special Value Shares would accrue to Mr. Dunin.

An unlimited number of Class C shares – the "New Common Shares"

c. These were ordinary common shares. The economic benefit of the value of PMPL would accrue to the holders of the New Common Shares, except for the amount attributable to the retraction value of the Freeze Shares and the Special Value Shares. The New Common Shares would be issued to corporations controlled by two trusts resident in Barbados, one established for the benefit of Mr. Garron and his family, the other for the benefit of Mr. Dunin and his family.

[21] In March of 1998, Mr. Dunin caused Dunin Holdings Ltd. ("Dunin Holdings") to be incorporated as an Ontario corporation. Mr. Dunin subscribed for the sole issued common share. On April 1, 1998, Mr. Dunin transferred his common shares of PMPL to Dunin Holdings in exchange for 499 common shares of Dunin Holdings. An election was made under subsection 85(1) of the *Income Tax Act* so that no capital gain arose on Mr. Dunin's disposition of the PMPL shares. At that point, the common shares of PMPL were owned as to 50% by Dunin Holdings and as to 50% by Garron Holdings.

[22] On April 2, 1998, Mr. Paul Ambrose, a resident of Kingstown, St. Vincent and a long time friend of Mr. Garron, settled two trusts at the request of Mr. Garron and to accommodate him. One of the trusts was settled for the benefit of Mr. Garron and his family (the Fundy Settlement, which for ease of reference I will refer to as the "Garron Trust"). The other trust was settled for the benefit of Mr. Dunin and his family (the Summersby Settlement, which I will refer to as the "Dunin Trust"). The Crown has conceded that the Garron Trust and the Dunin Trust were validly constituted trusts in the sense that the "three certainties" required for a trust were present.

[23] The Garron Trust and the Dunin Trust were each settled with US$100 of Mr. Ambrose's own funds, and he signed the trust indentures. Mr. Ambrose provided no input or instructions as to the content or terms of the trust indentures, but he reviewed them with a lawyer from St. Vincent and the Grenadines, Agnes E. Cato, who also witnessed his signature.

[24] It was planned that the Garron Trust would acquire the shares of a newly incorporated Ontario corporation, 1287333 Ontario Ltd. ("New Garron Co") which in turn would acquire 800 of the New Common Shares of PMPL. The Dunin Trust would acquire the shares of another newly incorporated Ontario corporation, 1287325 Ontario Ltd. ("New Dunin Co"), which in turn would acquire 800 of the New Common Shares of PMPL as well as the 100 Special Value Shares of PMPL. As a result, the Dunin Trust (and thus Mr. Dunin and his family) would obtain the benefit of 10% of the increase in the value of PMPL in excess of the redemption value of the Freeze Shares, while any further increase in the value of PMPL would be shared equally by the Dunin Trust (benefiting Mr. Dunin and his family) and the Garron Trust (benefiting Mr. Garron and his family).

[25] The terms of the trust indentures that are relevant to these appeals are substantially the same except for the name of the trust and the identification of the beneficiaries. It is not necessary to recite all of the terms. A sufficiently accurate picture of the trust indentures emerges from the following summary:

a. The trustee was required to keep the trust property invested until the "Division Date" (any date chosen by the trustee or 80 years from the date of settlement, whichever occurred first), subject to the absolute discretion of the trustee to distribute some or all of the income to one or more beneficiaries, with any undistributed or unallocated income to be added to the capital.

b. The trustee had the absolute discretion to encroach on capital to or for the benefit of one or more of the beneficiaries, even to the extent of using all of the trust property.

c. On the division date, the property was to be divided and distributed as follows:

(i) in the case of the Garron Trust, equally among the children of Myron and Berna Garron or their children (subject to certain conditions relating to the age of the child at the division date); and

(ii) in the case of the Dunin Trust, to Mr. Dunin or, if he was not then living, equally to his children or their children (subject to certain conditions relating to the age of the child at the division date).

d. The trustee was precluded from distributing *in specie* the Class A shares of New Garron Co (in the case of the Garron Trust) or New Dunin Co (in the case of the Dunin Trust), but had the power at any time to convert those shares to cash or other property which could then be distributed in accordance with the general power of distribution.

e. Except for the specific prohibition relating to distribution *in specie* of the Class A shares of New Garron Co and New Dunin Co, the trustee was given broad powers to invest and to make payments and distributions in money or other property of the trust, and the power to retain or sell any property in any manner and on any terms.

f. The protector had the absolute discretion to remove a trustee and appoint a new trustee.

g. The protector could be removed and a new protector appointed by the majority of beneficiaries who had attained a specified age.

[26] As mentioned above, St. Michael Trust Corp. was the trustee of the Dunin Trust and the Garron Trust. St. Michael Trust Corp. was incorporated in Barbados and began its operations in 1987. At that time its shares were owned by the Barbados partners of the accounting firm Price Waterhouse, which later merged with Coopers & Lybrand. After the merger, the Barbados partners of the merged firm, PricewaterhouseCoopers, became the shareholders of St. Michael Trust Corp.

Justice Woods referred to the Barbados partners of both the merged firm and its Price Waterhouse predecessor as "PwC-Barbados", and I will do the same. The shares of St. Michael Trust Corp. were sold in 2002 and again in 2008, but those transactions are not relevant to any of the issues raised in this appeal.

[27] At all times relevant to this appeal, St. Michael Trust Corp. was licensed as a trustee under the *Financial Institutions Act* of Barbados and regulated by the Central Bank of Barbados. It was subject to the *Trustees Act* of Barbados. Its sole business activity was the administration of trusts and acting as a trustee, which it carried on only in Barbados. It had only one office, which was in Barbados. Its business records and the records of all of the trusts under its administration were in Barbados. Its board of directors met in Barbados.

[28] St. Michael Trust Corp. contends that at all relevant times, it was a resident of Barbados for purposes of the Barbados Tax Treaty. Justice Woods considered it unnecessary to reach a conclusion on that point and she declined to do so. However, there can be no doubt that, for the purposes of the Barbados Tax Treaty, St. Michael Trust Corp., in its own right and in relation to its own tax affairs, would be considered a resident of Barbados and not a resident of Canada. One of the issues raised in this appeal is whether, as a matter of law, the residence of St. Michael Trust Corp. is necessarily the same as the residence of the Garron Trust and the Dunin Trust. That point is addressed later in these reasons.

[29] At the time of the transactions in issue in this case, the acts of St. Michael Trust Corp. in its capacity as trustee of the Garron Trust and the Dunin Trust were fulfilled by Mr. Peter Jesson, a tax partner of PwC-Barbados and a director of St. Michael Trust Corp., and Mr. Jim Knott, the general manager of St. Michael Trust Corp. They had both retired by the time of the Tax Court hearing, and neither of them gave evidence.

[30] From 2003 until the time of the Tax Court hearing, the acts of St. Michael Trust Corp. in its capacity as trustee of the Garron Trust and the Dunin Trust were performed by Mr. Ian Hutchinson, the president and a director of St. Michael Trust Corp. Mr. Hutchinson's background was as an accountant with Coopers & Lybrand in Barbados. He moved to the trust division of PwC-Barbados in 1999 but until 2003, his involvement with the Trusts was limited to "investment recording." He gave evidence at the Tax Court hearing.

[31] Mr. Jesson signed a memorandum dated April 9, 1998 with respect to the Garron Trust (the Fundy Settlement) that reads as follows:

> It is the Trustee's intention, with respect to the Fundy Settlement (Trust) [the Garron Trust] as follows:
>
> 1. Investment Policy
>
>   a. that the shares of 1287333 Ontario Limited [New Garron Co] be held until such time as the other shareholders of PMPL Holdings Inc., decide to sell their shares. At that time we will facilitate the sale of the shares of [New Garron Co];
>
>   b. any sale proceeds which arise from the sale of the shares of [New Garron Co] (and any other amounts

> received by the [Garron Trust] as a consequence of the realisation of any assets of [New Garron Co] or of any entity in which it has a direct or indirect interest) will be invested prudently with a view to the long term preservation of the capital of the [Garron Trust]; and
>
> c. we will seek the investment advice of Myron Garron from time to time.
>
> 2. Distribution Policy
>
> a. that during the lifetime of Myron Garron the primary consideration in making distributions of income and capital should be the best interests of Myron Garron subject only to his wishes with respect to distributions to other beneficiaries;
>
> b. if Myron Garron should die at a time we continue to hold assets under the terms of the [Garron Trust], distribution shall be made in view of the best interests of Myron Garron's widow during her lifetime, and thereafter the best interests of his issue, as defined in the [Garron Trust] deed.

[32] Mr. Jesson also signed a memorandum dated April 29, 1998 with respect to the Dunin Trust (the Summersby Settlement) which reads as follows:

> 1. Investment Policy
>
> a. the shares of 1287325 Ontario Limited [New Dunin Co] should be held until such time as the other shareholders of PMPL Holdings Inc. decide to sell their shares. At that time, we, as the trustee, will facilitate the sale of our shares of [New Dunin Co];
>
> b. any sale proceeds which arise from the sale of our shares of [New Dunin Co] (and any other amounts received by the [Dunin Trust] as a consequence of the realisation of any assets of [New Dunin Co] or of any entity in which it has a direct or indirect interest) will

be invested prudently with a view to the long term preservation of the capital of the [Dunin Trust]; and

c. we, as trustee, may seek the investment advice of Andrew Dunin, from time to time.

2. Distribution Policy

During the lifetime of Andrew Dunin, the primary consideration in making distributions of income and capital should be the best interests of Andrew Dunin, subject only to his wishes with respect to distributions to other beneficiaries. If Andrew Dunin should die at a time when we, as trustee, continue to hold assets under the terms of the [Dunin Trust], distributions shall be made in view of the best interests of Andrew Dunin's widow during her lifetime, and thereafter

the best interests of his issue (as defined in the Settlement Deed).

3. Power to Amend Trust

We, as trustee, will consult with Andrew Dunin each April (*) to determine whether the provision of clauses 3.1(e)(iv) or 3.1(f) of the Settlement Deed should be amended to reflect any amendments which might have been made to the will of Andrew Dunin.

[33] On April 2, 1998, Mr. Julian Gill, another friend of Mr. Garron and the person named as the protector for the Trusts, lent each Trust US$7,190. The terms of the loans stipulated a 10% rate of interest. The loan to the Dunin Trust was repayable upon the sale of its shares of New Dunin Co or the receipt of a dividend from New Dunin Co. The loan to the Garron Trust was repayable upon the sale of its shares of New Garron Co or the receipt of a dividend from New Garron Co. The events triggering the Trusts' obligations to repay the loans (described below) occurred in August, 2000, and the loans were repaid with interest at that time.

[34] On April 3, 1998, the Garron Trust acquired 1,000 Class A and 1,000 Class B shares of New Garron Co, and the Dunin Trust acquired 1000 Class A and 1000 Class B shares of New Dunin Co.

[35] On April 6, 1998, the following transactions occurred. The reorganization of the share capital of PMPL was completed as described above. 1000 Freeze Shares of PMPL were issued to replace the original common shares owned by Garron Holdings and Dunin Holdings, so that Garron Holdings and Dunin Holdings each became the owner of 500 Freeze Shares of PMPL. New Garron Co subscribed for 800 New Common Shares of PMPL for $80. New Dunin Co subscribed for 100 Special Value Shares of PMPL for $10 and 800 New Common Shares of PMPL for $80.

[36] The value of the common shares of PMPL immediately before the April 6, 1998 reorganization was the subject of conflicting expert opinion in the Tax Court. For purposes of the reorganization the parties had valued them at $50 million, based on a valuation opinion they obtained early in 1998. The Minister assumed, when reassessing the appellants, that the fair market value immediately before the reorganization was substantially more than $50 million. The Crown's expert valued them at $102 million.

[37] Justice Woods concluded, for reasons that are well explained, that the Minister's assumption had not been rebutted, but she did not consider it necessary to determine the value. Therefore, for purposes of this appeal, it must be taken as a fact that the pre-reorganization value was substantially more than $50 million.

[38] As a practical matter, that means that the redemption value of the Freeze Shares was fixed at an amount, $50 million, that was less than their actual value, resulting in a shift in the value of PMPL from the holders of the Freeze Shares (Garron Holdings and Dunin Holdings) to the holders of the New Common Shares (the Trusts). The articles of incorporation of PMPL contain a provision that would have adjusted the redemption value of the Freeze Shares upon a determination by a taxing authority or a court that the fair market value of the Freeze Shares was some amount other than $50 million, but that clause was never in play because no such determination was made.

[39] After the reorganization, the companies owned by PMPL continued to operate, apparently with substantial success. During the first half of 1999, negotiations occurred in an attempt to sell PMPL to a Swiss company at Mr. Dunin's then estimated value of $400 million, but those negotiations did not succeed. In approximately June of 1999, Mr. Dunin retained Mr. Timothy W. Carroll of the Chicago office of Arthur Anderson to find a buyer and manage the sale. An equity firm based in New York, Oak Hill Capital Partners, L.P., expressed an interest and, in August of 2000, acquired indirect interests in PMPL through a Canadian corporation, 1424666 Ontario Ltd. (the "Purchaser"). It is common ground that the Purchaser dealt at arm's length with St. Michael Trust Corp., Mr. Dunin and Mr. Garron.

[40] It seems to have been accepted by all parties that in 2000, the value of PMPL was approximately $532 million. It was intended that the Purchaser would acquire indirect interests in PMPL for approximately $482 million, and Mr. Dunin and the Dunin Trust would retain indirect interests in PMPL valued in total at approximately $50 million.

[41] This was achieved through the following transactions. The Garron Trust sold all of its shares of New Garron Co to the Purchaser for approximately $217 million. The Dunin Trust sold 907 of its 1000 Class A shares and 907 of its 1000 Class B shares of New Dunin Co (90.7% of the shares) to the Purchaser for approximately $240 million. The shareholders of Garron Holdings (which owned 500 Freeze Shares of PMPL) sold all of their shares of Garron Holdings to the Purchaser for $25 million. Dunin Holdings exchanged its 500 Freeze Shares of PMPL for shares of the Canadian parent corporation of the Purchaser valued at $25 million.

[42] After these sales were completed, the Purchaser indirectly held substantially all of PMPL, for which it had paid approximately $482 million. Its indirect interests in PMPL were represented by all of the shares of Garron Holdings which owned 500 Freeze Shares of PMPL (valued at approximately $25 million), all of the shares of New Garron Co which owned 800 New Common Shares of PMPL (valued at approximately $217 million), and 907 Class A and 907 Class B shares of New Dunin Co which owned the 100 Special Value Shares and 800 New Common Shares of PMPL (valued at approximately $240 million).

[43] Mr. Dunin's retained indirect interests in PMPL were represented by his continued ownership of the shares of Dunin Holdings, which owned newly issued shares of the Purchaser's parent corporation (valued at approximately $25 million). That parent corporation in turn owned 500 Freeze Shares of PMPL and a controlling interest in the Purchaser, which in turn owned or controlled the remaining shares of PMPL. Mr. Dunin was also a discretionary beneficiary of the Dunin Trust, which retained a 9.3% equity interest in New Dunin Co valued at approximately $25

million (represented by 93 Class A and 93 Class B shares of New Dunin Co, which owned the 100 Special Value Shares and 800 New Common Shares of PMPL).

[44] The sales by the Garron Trust and the Dunin Trust of the shares of New Garron Co and New Dunin Co, respectively, gave rise to the capital gains that are the subject of the income tax assessments under appeal. Those gains were not subject to tax in Barbados. Because the shares of New Garron Co and New Dunin Co were acquired at a nominal cost, the capital gains were determined for Canadian income tax purposes to be approximately $217 million for the Garron Trust and approximately $240 million for the Dunin Trust. The capital gain inclusion rate at the relevant time was 2/3, so that the taxable amounts were approximately $145 million for the Garron Trust and approximately $160 million for the Dunin Trust.

[45] In addition to the facts summarized above relating to the transactions underlying the assessments under appeal, Justice Woods concluded that the role of St. Michael Trust Corp. was, by mutual agreement, more limited than the text of the trust indentures would suggest. Her findings in this respect are explained fully in paragraphs 189 to 262 of her reasons. The appellant argues that Justice Woods made a palpable and overriding error in concluding that the Trusts were controlled and managed by anyone other than St. Michael Trust Corp. Justice Woods's specific factual findings on this issue and her reasons are discussed in the analysis below.

[46] The Purchaser, in compliance with section 116 of the *Income Tax Act*, withheld from the proceeds of sale approximately $72 million in respect of the purchase of the shares of New Garron

Co from the Garron Trust and approximately $80 million in respect of the purchase of the shares of New Dunin Co from the Dunin Trust. The withheld amounts were remitted to the Minister to be credited to the Garron Trust and the Dunin Trust respectively.

[47] St. Michael Trust Corp. took the position that, because the Garron Trust and the Dunin Trust were residents of Barbados for purposes of the Barbados Tax Treaty, their capital gains were exempt from income tax in Canada because of paragraph 4 of Article XIV. In order to claim refunds of the amounts withheld and remitted by the Purchaser, St. Michael Trust Corp. filed income tax returns for the Garron Trust and the Dunin Trust. The capital gains were disclosed in those returns and claims for a treaty exemption were asserted.

[48] The Minister rejected the claims for exemption and assessed St. Michael Trust Corp. accordingly. St. Michael Trust Corp. objected to the assessments without success, and appealed to the Tax Court of Canada again without success. I summarize as follows the key conclusions reached by Justice Woods:

a. In determining residence for purposes of the *Income Tax Act*, the established test of residence applicable to corporations should be applied, so that a trust is resident in the country where its central management and control is exercised. In relation to the Trusts, the essential responsibility for decision making was intended from the outset to be exercised, and was in fact exercised, by Mr. Dunin and Mr. Garron, not St. Michael Trust Corp. Therefore, the central

management and control of the Trusts was located in Canada, and the Trusts were resident in Canada.

b. As to the Crown's alternative arguments:

i. the Trusts were not deemed to be resident in Canada by virtue of section 94 of the *Income Tax Act* because the contribution test was not met;

ii. even if the Trusts were deemed to be resident in Canada by virtue of section 94, they could not be considered "residents of Canada" as defined in the Barbados Tax Treaty because section 94 does not impose tax liability on a deemed resident trust on the same comprehensive basis as a trust that is actually resident in Canada (*Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802); and

iii. the assessments under appeal cannot be justified by the general anti-avoidance rule. It is not an abuse of the Barbados Tax Treaty to vest property in a trust with its residence in Barbados in a manner that avoids the operation of section 94. Generally, a tax treaty is intended to override the *Income Tax Act*, and there is nothing in the statutory context to indicate that the Bahamas Tax Treaty was not intended to override the *Income Tax Act* in the circumstances of this case.

[49] St. Michael Trust Corp. now appeals to this Court on the first issue summarized above. The Crown argues that Justice Woods was correct on the first issue, but if she was wrong on that issue, she was also wrong in rejecting the Crown's alternative arguments.

Issues

[50] I summarize as follows the issues raised in these appeals:

a. *Residence under general legal principles:* Did Justice Woods err in law or fact in concluding that, for the purposes of the *Income Tax Act*, the Trusts were resident in Canada in 2000? If not, then the appeals cannot succeed. Otherwise, it will be necessary to consider question (b).

b. *Deemed residence under subsection 94(1)*:

i. Did Justice Woods err in law in concluding that the deemed residence rule in subsection 94(1) of the *Income Tax Act* did not apply to the Trusts in 2000? If so, then it will be necessary to consider question (b)(ii). If Justice Woods made no error on this point, then it will be necessary to consider question (c).

ii. If the Trusts were deemed to be resident in Canada by virtue of subparagraph 94(1), were they nevertheless "residents of Barbados" and not "residents of Canada" for the purposes of the Barbados Tax Treaty, and thus entitled to the benefit of the

exemption in paragraph 4 of Article XIV of the Barbados Tax Treaty? If not, the appeals cannot succeed. If so, it will be necessary to consider question (c).

c. *The general anti-avoidance rule*: If the Trusts were not resident in Canada and were residents of Barbados for purposes of the Barbados Tax Treaty, does GAAR nevertheless justify the assessments under appeal? If so, the appeals cannot succeed.

[51] For the reasons that follow, I have concluded that these appeals should be dismissed. I agree with Justice Woods that a central management and control test, as described below, should be applied in determining the residence of the Trusts. In my view, it was reasonably open to her to conclude on the basis of the record that for the purposes of the *Income Tax Act*, the Trusts were resident in Canada in 2000.

Analysis

Residence of the Trusts under general legal principles

[52] Canada, like many countries, has chosen residence as the principal basis for imposing income tax. The policy reason for that choice, as explained by Professor Vern Krishna (*The Fundamentals of Canadian Income Tax* (10th ed., Toronto: Carswell, 2009), at page 85), is that a person who enjoys the legal, political and economic benefits of association with Canada should bear the appropriate share of the costs of association.

[53] Generally, the residence of a person is a question of fact, the determination of which requires consideration of any number of factors that point to or away from an economic or social link between the person and a particular country. For example, in the case of an individual, the relevant factors could include nationality, physical presence, location of the family home, location of business and social interests, mode of family life, and social connections through birth or marriage (a more detailed list of specific factors can be found in Krishna, at pages 88-91). Some specific legal principles for determining residence may come into play in certain circumstances, but none that eliminate the need for full consideration of all of the relevant facts.

[54] As to the residence of a corporation, it was determined over 100 years ago that in considering that question, the jurisprudence relating to the residence of an individual was instructive. In the leading case of *De Beers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455, Lord Loreburn said this (at page 458):

> In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company. Otherwise it might have its chief seat of management and its centre of trading in England under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. The decision of Kelly C.B. and Huddleston B. in the *Calcutta Jute Mills v. Nicholson* and the *Cesena Sulphur Co. v. Nicholson* [(1876) 1 Ex D. 428], now thirty years ago, involved the principle that a company resides for purposes of income tax where its real business is carried on. Those decisions have been acted upon ever since. I regard that as the true rule, and the real business is carried on where the central management and control actually abides.

> It remains to be considered whether the present case falls within that rule. This is a pure question of fact to be determined, not according to the construction of this or that regulation or bye-law, but upon a scrutiny of the course of business and trading.

[55] It remains the case to this day that, for income tax purposes, the residence of a corporation is determined primarily by finding the location of the corporation's central management and control, which is a question of fact. The relevant factors include the legal indicia of the place where the corporation's management and control should be exercised (as disclosed, for example, by the corporation's governing law and constating documents). Where a corporation is actually managed and controlled by its directors in the manner contemplated by its governing law, the residence of a corporation usually will be determined as the place where the corporate directors exercise their management and control responsibilities.

[56] However, that may not be the result if the facts disclose that the corporation is not in fact managed and controlled as its governing law requires. In that regard it is relevant to consider the nature of the decision making authority actually exercised by the directors. If significant management decisions are in fact taken by a person who is not a director, the place where that person resides or operates may be determined to be the residence of the corporation. Thus, for example, if it is established that management and control is exercised in fact by a shareholder operating out of another country, the corporation may be found to be resident where the shareholder resides: see *Unit Construction Co. Ltd. v. Bullock*, [1960] A.C. 351.

[57] There is very little jurisprudence relating to the determination of the residence of a trust for tax purposes. Justice Woods reviewed the jurisprudence and concluded, correctly in my view, that there is no case law establishing a single test for determining the residence of a trust. She also concluded that "the judge-made test of residence that has been established for corporations should also apply to trusts, with such modifications as are appropriate" (reasons, paragraph 162). I agree with her, substantially for the reasons she gave.

[58] Some learned writers on tax matters have expressed the opinion that the residence of a trust is determined solely by the residence of the trustee, citing cases where the residence of a trust has been found to be the place where the trustee resides (or, in one case, in the place where the majority of the trustees reside, the trust indenture having permitted the majority to act for the trust: see *Trustee of Thibodeau Family Trust v. Canada*, [1978] F.C.J. No. 607, 78 DTC 6376 (T.D.)).

[59] However, no case has established that the residence of the trustee is an invariable legal test for the residence of the trust. Nor has any case rejected conclusively the central management and control test as an appropriate legal test for the residence of a trust in a situation where it was found, for example, that someone other than the trustee exercised management and control of the trust property, or that the trustee resided in one place but exercised the management and control of the trust property in another place.

[60] Certain comments in *Thibodeau* have sometimes been taken as a rejection of the corporate test of residence for a trust. In fact the Crown had submitted in that case that the central

management and control test should be applied, and that submission was rejected. However, the comments that are most often cited in support of a blanket rejection of the central management and control test for a trust were made in the context of a narrower submission to the effect that the trust could have been resident in two places because one trustee lived in Canada and two lived in Bermuda. What the judge said (at paragraph 22; DTC page 6385) is this:

> As to the submission that the Court in this case, even it if also finds that the Trust has a residence in Bermuda, it should find that it has a residence in Canada in that part of the paramount or supreme authority in relation to the management of this Trust was carried on in Canada applying by analogy the principles in the cited cases of determining residence for income tax purposes of corporations, in my view, such submission is also not valid. The judicial formula for this respecting a corporation, in my view, cannot apply to trustees because trustees cannot delegate any of their authority to co-trustees. A trustee cannot adopt a "policy of masterly inactivity" as commented upon in Underhill on the Law of Trusts and Trustees, 12th Edition, page 284; and on the evidence, none of the trustees did adopt such a policy. Therefore, it is not possible for a trust to have a dual residence for income tax purposes, and therefore it is not possible to find that part of the paramount of "superior and directing authority" of a Trust is and was in two places. In any event, a finding of dual residence of this Trust is not made in this case.

[61] I do not read this paragraph as rejecting the proposition that the residence of a trust can never be determined on the basis of the place where its central management and control is exercised and must always be determined exclusively on the basis of the residence of the trustee. However, if that is what the judge in *Thibodeau* was saying, then I respectfully disagree.

[62] By analogy from *DeBeers, supra*, the task is to determine where a trust "keeps house and does business", i.e. where the powers and discretions of the trustee are really being exercised. It may well be that in most cases, the residence of the appointed trustee is a sufficient basis in fact for

determining the residence of the trust. This is the case where the trustee is given and actually exercises the powers and discretions regarding the management and control of the trust property, and does so where he resides. However, a rigid legal test that *necessarily* ties the residence of a trust to the residence of the trustee regardless of the facts is, in my view, not sound in principle because it denies the central theme of the jurisprudence on the determination of residence for tax purposes, which is that residence fundamentally is a question of fact. I conclude therefore that where a question arises as to the residence of a trust for tax purposes, it is appropriate to undertake a fact driven analysis with a view to determining the place where the central management and control of the trust is actually exercised.

[63] St. Michael Trust Corp. argues that a test of central management and control cannot be applied to a trust because a trust is a "legal relationship" without a separate legal personality. I do not accept this argument. It is true that as a matter of law a trust is not a person, but it is also true that for income tax purposes, a trust is treated as though it were a person. In my view, it is consistent with that implicit statutory fiction to recognize that the residence of a trust may not always be determined by the residence of its trustee.

[64] St. Michael Trust Corp. also argues that the residence of the trust must be determined as the residence of the trustee because section 104 of the *Income Tax Act* embodies the trust, as taxpayer, in the person of the trustee. In my view, that gives section 104 a meaning beyond its words and purpose. Section 104 was enacted to solve the practical problems of tax administration that would necessarily arise when it was determined that trusts were to be taxed despite the absence of legal

personality. I do not read section 104 as a signal that Parliament intended that in all cases, the residence of the trust must be the residence of the trustee.

[65] Finally, St. Michael Trust Corp. argues that, even if the residence of the Garron Trust and the Dunin Trust in 2000 was the place where their central management and control was exercised at that time, Justice Woods made a palpable and overriding error in applying that test to the facts. To assess the validity of that argument, it is necessary to consider the factors that Justice Woods took into account in locating the central management and control of the Trusts in Canada, where Mr. Garron and Mr. Dunin resided.

[66] Justice Woods concluded that St. Michael Trust Corp. was not exercising the main powers and discretions of the trustees under the trust indentures. Rather its true role was "to execute documents as required, and to provide incidental administrative services", and it was not expected to "have responsibility for decision-making beyond that" (at paragraph 189). Rather than exercising its powers and discretions under the trust indentures, St. Michael Trust Corp. would default automatically to the recommendation of Mr. Dunin and Mr. Garron. This was "understood to be the arrangement from the outset" (at paragraph 194). She found that it was Mr. Dunin and Mr. Garron "who made the substantive decisions respecting the Trusts", not St. Michael Trust Corp. (at paragraph 252). In reaching these conclusions, Justice Wood relied on a number of facts which are fully stated in her reasons. I summarize as follows a number of these facts:

a. Under the terms of the trust indentures, Mr. Garron and Mr. Dunin and their respective spouses alone could replace the protector, who in turn could replace the trustee, if the trustee acted against their wishes.

b. The limited role of St. Michael Trust Corp. was understood by all parties at the outset. In particular, it was understood that St. Michael Trust Corp. would have no decision making role in relation to the sale of the Trusts' interests in PMPL, the investment of the cash proceeds received on the sale, the making of distributions to the beneficiaries, and the taking of appropriate action to minimize the tax burden of the Trusts. It was further understood from the outset that decisions of that nature would be made by Mr. Garron and Mr. Dunin and implemented by St. Michael Trust Corp. under their direction.

c. The Trusts used the same investment advisers as the beneficiaries. This allowed the beneficiaries to deal directly with the Trusts' financial advisers and directly control the Trusts' investment activity without the involvement of St. Michael Trust Corp.

d. The tax advisers to Mr. Garron and Mr. Dunin were also used for the Trusts and when acting for the Trusts were directed by Mr. Garron and Mr. Dunin.

e. There is no documentary evidence that St. Michael Trust Corp. took an active role in managing the Trusts, and the correspondence and other documents introduced by the

Crown indicated that St. Michael Trust Corp. had no involvement in the affairs of the Trusts except the execution of documents and in administrative, accounting and tax matters.

f. St. Michael Trust Corp. was an arm of an accounting firm and thus had significant expertise in tax and accounting matters, but there is no evidence that it had any expertise in the management of trust assets.

g. The oral evidence of Mr. Garron and Mr. Dunin did not provide a clear picture of how the Trusts operated, and was less than full and complete.

h. Mr. Dunin in particular was disingenuous when he testified that St. Michael Trust Corp. controlled the Trusts.

i. Mr. Dunin attempted to give the impression that he had little interest in what St. Michael Trust Corp. was actually doing *vis-à-vis* the Dunin Trust which, given his economic interest in the Dunin Trust, supports the conclusion that it was Mr. Dunin himself who was in effective control. The same can be said about the evidence of Mr. Garron that he had little interest in what St. Michael Trust Corp. was doing.

j. Other individuals who could have shed light on the relevant facts as to the operation of the Trusts were not called to give evidence. That included the various advisers

who were involved in planning and implementing the relevant transactions, Mr. Gill who was the protector of both Trusts, Mr. Jesson who was in charge of St. Michael Trust Corp. when the Trusts were created and the person who prepared the memoranda of "trustee intentions" quoted above, Mr. Knott who had the day to day responsibility for the Trusts, Mr. Carroll who was the lead adviser on the sale of PMPL, and various other individuals who acted as investment advisers to the Trusts or who were involved in the selection of investment advisers.

k. The evidence of Mr. Hutchinson, an officer of St. Michael Trust Corp. who dealt with the Trusts, was not particularly helpful because of his lack of personal knowledge of events that occurred before his involvement in 2003. In particular, Mr. Hutchinson could provide no useful information about the degree of due diligence undertaken by St. Michael Trust Corp. in relation to any of the relevant transactions.

l. Mr. Hutchinson testified that the directors of St. Michael Trust Corp. were required to ratify actions proposed to be taken or taken by the Trusts, but there is no evidence that they had much substantive information about the transactions, which tends to support the proposition that they knew that the role of St. Michael Trust Corp. was intended to be limited to administrative matters.

[67] Some of the factors listed above are common characteristics of ordinary trusts and, considered in isolation, would not be sufficient to locate the management and control of the Trusts

anywhere but the residence of the St. Michael Trust Corp. For example, the fact that the beneficiaries have the right to appoint a protector who has the power to replace the St. Michael Trust Corp. as trustee is a common safeguard in a trust indenture and would not by itself be enough to find the beneficiaries to be in control of the property of the Trusts. The same could be said of the fact that St. Michael Trust Corp. and the beneficiaries employ common advisers, or the fact that the beneficiaries took it on themselves to advise the St. Michael Trust Corp. and even urged St. Michael Trust Corp., however strongly, to undertake a particular transaction. Indeed, the appointment of a trustee with little investment experience in a trust that requires the property to be invested might not be significant, provided that the trustee has the power to retain others for advice and, in the end, is the one making the decisions.

[68] However, there is a line to be drawn. On one side of the line are recommendations, even strong ones, by the beneficiaries to the trustee, leaving the trustee free to decide how to exercise the powers and discretions under the trust. In that case, the trustee is still managing and controlling the trust. On the other side of the line the beneficiaries are really exercising the powers and discretions under the trusts, managing and controlling the trusts, and displacing the appointed trustee. As mentioned above, on which side of the line a case falls is a factual question, requiring consideration of the evidence in its totality.

[69] Justice Woods took into account some normally neutral facts, such as the existence of a protector and reliance on common advisers, and combined them with a considerable body of

evidence of the surrounding circumstances to conclude that on the facts of this case, the line was crossed. In my view, it was reasonably open to her to reach that conclusion.

[70] Indeed, what else is to be made of the common understanding of the parties, as found by Justice Woods, that decisions in relation to the sale of the Trusts' interests in PMPL, the investment of the cash proceeds received on the sale, the making of distributions to the beneficiaries, and the taking of appropriate action to minimize the tax burden of the Trusts would be made by Mr. Garron and Mr. Dunin and implemented by St. Michael Trust Corp.? What else explains the lack of documentary or other evidence that St. Michael Trust Corp. took an active role in assessing any of the important decisions relation to the disposition of the property of the Trust? What is the explanation for the professed lack of interest on the part of Mr. Garron and Mr. Dunin of the capabilities of St. Michael Trust Corp. to manage trust assets, except in relation to the work ordinarily done by someone with accounting and tax expertise? What is the explanation for the paucity of evidence as to the formation and operation of the Trusts and the failure to call key witnesses?

[71] I conclude that Justice Woods made no error warranting the intervention of this Court in concluding that, at the relevant time in 2000, and in particular at the time of the sale of the shares of New Garron Co and New Dunin Co to the Purchaser, the management and control of the Garron Trust and the Dunin Trust resided in Canada with Mr. Garron and Mr. Dunin. It follows that she was correct to find that the Trusts were resident in Canada when they realized capital gains on the sale of the shares of New Garron Co and New Dunin Co.

[72] This is a sufficient basis upon which to dismiss these appeals. However, as the alternative arguments were fully argued, I will express an opinion on those as well.

Deemed residence of the Trusts under subsection 94(1)

[73] If, contrary to the opinion expressed above, the residence of a trust is to be determined only on the basis of the residence of the trustee, then there can be no real doubt that the Trusts were resident in Barbados in fact and for the purposes of the Barbados Tax Treaty. The question then becomes whether section 94 applied to the Trusts in 2000, and if so whether the capital gains in issue are subject to tax in Canada. That turns on two issues: (1) whether the contribution test in paragraph 94(1)(*b*) was met, and (2) whether the Trusts were entitled to the exemption in paragraph 4 of Article XIV of the Barbados Tax Treaty.

[74] The contribution test was met if the Garron Trust and the Dunin Trust acquired property, "directly or indirectly in any manner whatever" from a Canadian resident beneficiary or a person related to that beneficiary. Each of the Trusts had a Canadian resident beneficiary, Mr. Garron in the case of the Garron Trust, and Mr. Dunin in the case of the Dunin Trust, and among the players in this case were two corporations, Garron Holdings and Dunin Holdings, that for income tax purposes are related to Mr. Garron and Mr. Dunin respectively. Therefore, the specific questions are whether the Garron Trust acquired property, directly or indirectly in any manner whatever from Mr. Garron or Garron Holdings, and whether the Dunin Trust acquired property directly or indirectly in any manner whatever from Mr. Dunin or Dunin Holdings.

[75] There are undoubtedly many ways in which a transfer of property may occur directly or indirectly in any manner whatever, and there is very little guiding jurisprudence. However, it is now well established that if the existing common shares of a corporation worth, say, $100, are exchanged for preference shares with a value that is fixed at some lesser amount, say, $80, and new common shares are issued to a new shareholder for nominal consideration, the holders of the preference shares have indirectly transferred property worth $20 to the new subscriber (see *Canada v. Kieboom (C.A.)*, [1992] 3 F.C. 488, at paragraph 21).

[76] *Kieboom* recognizes that the entire value of any corporation is represented by its shares, which are property. The allocation of the value of a corporation between shares of different classes is determined by their terms and conditions. Therefore it is possible to change the value of a class of shares, and to shift value from one class of shares to another, by changing their terms and conditions. The hypothetical reorganization described above results in an indirect transfer of property worth $20 from the holders of the fixed value preference shares to the new subscriber.

[77] The same kind of indirect transfer of property occurred in this case upon the reorganization of the shares of PMPL. The pre-reorganization value of the common shares of PMPL was substantially more than $50 million, the redemption value of the Freeze Shares for which they were exchanged upon the reorganization. For that reason, the reorganization shifted value from the holders of the Freeze Shares (Dunin Holdings and Garron Holdings) to the subscribers for New Common Shares of PMPL, New Dunin Co and New Garron Co. *Kieboom* teaches that Dunin

Holdings and Garron Holdings transferred property indirectly to New Dunin Co and New Garron Co respectively.

[78] However, the question asked by paragraph 94(1)(*b*) is whether property was transferred "directly or indirectly in any manner whatever" to the Dunin Trust and the Garron Trust, as the sole shareholders of New Dunin Co and New Garron Co respectively. Justice Woods said no, because this would require "looking through" New Dunin Co and New Garron Co to find that the Trusts were the recipients of the transferred property, which would give the phrase "directly or indirectly in any manner whatever" a meaning that would be unreasonably broad with unforeseeable and uncertain consequences in other situations.

[79] I do not share Justice Woods' concerns, and I respectfully disagree with her interpretation of paragraph 94(1)(*b*). Once it is accepted that an indirect transfer of the shares of a corporation from Shareholder A to Shareholder B can be achieved by a corporate reorganization that shifts part of the value of the corporation from the class of shares owned by Shareholder A to the class of shares owned by Shareholder B, I see no principled basis for concluding that the same transaction cannot also be an indirect transfer of property "in any manner whatever" to the person that owns Shareholder B. This does not imply any change to the legal principle that the property of a corporation is not the property of its shareholders. It merely recognizes the fact that any increase in the wealth of Shareholder B will necessarily increase the wealth of whoever owns Shareholder B. In the hypothetical corporate reorganization described above, it does no violence to the language of

paragraph 94(1)(*b*) to conclude that there has been an indirect transfer of property "in any manner whatever" from Shareholder A to the owner of Shareholder B.

[80] In my view, Parliament chose the words "directly or indirectly in any manner whatever" in paragraph 94(1)(*b*) deliberately to capture every possible means by which the wealth and income earning potential represented by the shares of a Canadian corporation can move to a non-resident trust from a Canadian resident beneficiary of the trust or a person related to that beneficiary. On any realistic and practical view of the facts of this case, the New Common Shares of PMPL (bearing with them the value shifted from the old common shares upon the reorganization of PMPL) were intended to enrich the Trusts. That was achieved by a series of interrelated and preordained transactions in which New Garron Co and New Dunin Co were the instruments by which the Trusts obtained the economic benefit of the New Common Shares of PMPL, including the portion of the value of those shares that was shifted from the pre-reorganization common shares. On that basis, I conclude that the contribution test was met, and therefore subsection 94(1) applied to the Trusts. It follows that paragraph 94(1)(c) applies to deem the Trusts to be resident in Canada for the purposes of Part I.

[81] The next question is whether the reasoning in *Crown Forest* compels the conclusion that the Trusts were entitled to the benefit of the exemption from Canadian tax in paragraph 4 of Article XIV of the Barbados Tax Treaty. Justice Woods concluded that the treaty exemption in this case trumps section 94. In my view, she was correct in so concluding.

[82] The treaty definition of residence follows the most common model. I repeat the definition here for ease of reference:

1. For the purposes of this Agreement, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.	1. Au sens du présent Accord, l'expression « résident d'un État contractant » désigne toute personne qui, en vertu de la législation dudit État, est assujettie à l'impôt dans cet État en raison de son domicile, de sa résidence, de son siège de direction ou de tout autre critère de nature analogue, et les expressions « résident du Canada » et « résident de la Barbade » ont le sens correspondant.

[83] *Crown Forest* teaches that the common element of the enumerated criteria in the treaty definition of residence is that each constitutes a basis on which states generally impose full tax liability on world-wide income. It follows that a person who is liable to tax in Canada only on income from a source or sources (source liability), as opposed to its world-wide income from all sources, would not be considered a resident of that state for treaty purposes. Justice Iacobucci, writing for the Court in *Crown Forest*, explained this point as follows at paragraph 40 (citations omitted):

> I agree with the appellant that the most similar element among the enumerated criteria is that, standing alone, they would each constitute a basis on which states generally impose full tax liability on world-wide income […]. In this respect, the criteria for determining residence in Article IV, paragraph 1 involve more than simply being liable to taxation on some portion of income (source liability); they entail being subject to as comprehensive a tax liability as is imposed by a state. In the United States and Canada, such comprehensive taxation is taxation on world-wide income. However, tax liability for the income effectively connected to a business engaged in the U.S., pursuant to s. 882 of the Internal Revenue Code,

> amounts simply to source liability. Consequently, the "engaged in a business in the U.S." criterion is not of a similar nature to the enumerated grounds since it is but a basis for source taxation.

[84] Substantially the same point is made more succinctly in the following statement from paragraph 68 of *Crown Forest,* in which Justice Iacobucci summarized his conclusions. His third conclusion is as follows:

> 3. The parties to the Convention intended only that persons who were resident in one of the contracting states and liable to tax in one of the contracting states on their "world-wide income" be considered "residents" for purposes of the Convention.

[85] These comments were made in the context of a case in which a Bahamian corporation was attempting to claim the benefit of an exemption from Canadian tax in the *Canada-United States Income Tax Convention (1980)* on the basis that its United States tax liability arose because its "place of management" was in the United States. (The definition of residence in that treaty is substantially the same as the definition of residence in the Barbados Tax Treaty.) The Bahamian corporation had the status of a foreign corporation for United States income tax purposes, and was liable to taxation in the United States only on income effectively connected with the business conducted from its office in the United States (that is, business income earned in the United States).

[86] Justice Iacobucci concluded that the fact that the place of management of the Bahamian corporation was in the United States was not the basis of its United States tax liability, but only one of the factors in determining whether its business income was effectively connected with its United

States based business. The Bahamian corporation was taxed in the United States only as a foreign corporation, on a source basis, and not on its world wide income as it would have been if it were an American corporation. For that reason, it was not a resident of the United States for treaty purposes.

[87] The deemed residence rule in section 94 does not simply deem a foreign trust to be a person resident in Canada. It is substantially limited; it deems a foreign trust to be a person resident in Canada whose taxable income for the year is the total of its taxable income *earned in Canada* for the year, plus "foreign accrual property income" (or FAPI, which essentially consists of certain investment and other passive income, including capital gains, of a foreign corporation that are attributed to a Canadian resident shareholder in certain circumstances). These limitations result in a foreign trust being deemed to be a person resident in Canada, not for *all* purposes of Part I (which would make it liable to tax on all of its income, wherever earned), but only for the purposes of Part I that are relevant to the determination of its Canadian source income and its FAPI. As a practical matter, as the parties agree, that excludes only foreign active business income, but it nevertheless falls short of displacing the treaty definition of residence.

[88] It follows that, if the central management and control test discussed above does not apply, then the Trusts would be entitled to the benefit of paragraph 4 of Article XIV of the Barbados Tax Treaty, and would be exempt from Canadian tax on the capital gain they realized in 2000 on the sale of the shares of New Garron Co and New Dunin Co.

The general anti-avoidance rule

[89] If, contrary to the opinions expressed above, the residence of a trust is to be determined only on the basis of the residence of the trustee and therefore the Trusts are resident in Barbados, but are entitled to the exemption in paragraph 4 of Article XIV of the Barbados Tax Treaty, it would be necessary to consider whether the assessments under appeal are nevertheless justified by the general anti-avoidance rule in section 245 of the *Income Tax Act*. In this Court as in the Tax Court, that issue turns on whether the series of transactions that resulted in the Trusts becoming entitled to the treaty exemption in the face of section 94 is a misuse or abuse of the Barbados Tax Treaty. Justice Woods said no. I agree.

[90] If the residence of the Trusts is to be determined on the basis of the residence of St. Michael Trust Corp. (which is the premise for the Crown's argument based on the general anti-avoidance rule), then the Trusts have not avoided section 94. On the contrary, they have fallen squarely into it. The fact that the Trusts would also be entitled to a treaty exemption flows from the fact that in the Barbados Tax Treaty, Canada has agreed not to tax certain capital gains realized by a person who is a resident of Barbados. If the residence of the Trusts is Barbados for treaty purposes, the Trusts cannot misuse or abuse the Barbados Tax Treaty by claiming the exemption.

Conclusion

[91] I would dismiss the appeals on the basis that the Trusts are resident in Canada. I would award the Crown one set of costs.

"K. Sharlow"
J.A.

"I agree
M. Nadon J.A."

"I agree
David Stratas J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKETS:	A-419-09 and A-420-09

(APPEAL FROM THE JUDGMENT OF THE HONOURABLE MADAM JUSTICE WOODS OF THE TAX COURT, DATED SEPTEMBER 10, 2009, IN DOCKET NOS. 2006-1409 (IT)G AND 2006-1411(IT)G)

STYLE OF CAUSE:	St. Michael Trust Corp., as Trustee of the Fundy Settlement v. Her Majesty the Queen and St. Michael Trust Corp., as Trustee of the Summersby Settlement v. Her Majesty the Queen
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	September 30, 2010
REASONS FOR JUDGMENT:	Sharlow J.A.
CONCURRED IN BY:	Nadon J.A. Stratas J.A.
DATED:	November 17, 2010

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