

Case Name

Fundy Settlement v. Canada, 2012 SCC 14

Countries

Country of decision

Canada

Other countries

Barbados

Court

Supreme Court of Canada

Case Number

34056, 34057

Parties

Name

St. Michael Trust Corp., as Trustee of the Fundy Settlement; and St. Michael Trust Corp., as Trustee of the Summersby Settlement

Role

Appellant

Name

Her Majesty The Queen

Role

Respondent

Date of Decision

2012-04-12

Treaty Article(s) and Paragraph(s)

Treaty

Canada-Barbados Income Tax Agreement Act

Subject

Gains from the alienation of any property other than those listed in paragraphs 1, 2, and 3

Sign year

1980

Last amending protocol

November 8, 2011

Article

Article IV(1) and Article XIV(4)

Taxable years

2000

OECD Equivalent article(s) and Paragraph(s)

Article

Article XIII

Paragraph

5

Keywords

Residence of trusts; Canadian beneficiaries; Barbados trust; common law test for residence; central management and control test; withholding taxes.

Summary of Facts

This case involved two trusts, both sharing the same corporate trustee located in Barbados. The appeals were heard on common evidence.

Two Canadian residents held shares in PMPL, a Canadian corporation. A corporate reorganization was undertaken in anticipation of an eventual sale to a third party. Shares

in two Ontario holding companies were ultimately transferred to a discretionary family trust settled in Barbados for each of the Canadian residents and their families, who were the trust's beneficiaries. A resident of St. Vincent settled the two trusts. Both trusts' protector was another resident of St. Vincent who held the right to replace the trustee. The beneficiaries had the right to replace the protector.

As part of PMPL's ultimate sale to an arm's length party, the trusts disposed of their shares in the holding companies, realizing capital gains of over \$450 million. Approximately \$152 million in withholding taxes were remitted to Canadian tax authorities as required. The trusts then asked for a return of the withholding taxes, claiming an exemption from taxation on the capital gains under Article XIV(4) of the *Canada-Barbados Income Tax Convention*.

The Minister of National Revenue refused to recognize the exemption and assessed the trusts on the capital gains. Before the Tax Court of Canada, the primary ground invoked by the Minister was that the trusts were resident in Canada under the common law, or in the alternative, because they were deemed residents of Canada under paragraph 94(1)(c). The Minister also argued in the alternative that attribution rules applied to reattribute the capital gains to the Canadian residents, that the General Anti-Avoidance Rule applied to deny the treaty exemption, and that the proceeds of sale were not reasonably allocated and should be reallocated in part to the Canadian residents.

The Tax Court of Canada concluded that the proper common law test for trust residence is the central management and control test, extending the corporate residence test to trusts, and changing what many practitioners understood to be the previous legal principle in Canada that a trust is resident where the trustee resides. The Court explained that trusts and corporations have a similar asset-holding function, and for consistency in Canadian law, it was appropriate for both corporations and trusts to share the same common law test for residence. Under this test, the trusts were Canadian residents, with central management and control occurring in Canada while the Barbados trustee performed mere administrative functions. The Court went on to determine that the deemed residence rule could not apply in this case to trace the assets through holding companies, and even if it could, deemed residents are not residents for treaty purposes because they not fully liable for tax in Canada. The Tax Court of Court also rejected the Minister's other arguments.

The Federal Court of Appeal upheld the Tax Court of Canada's conclusion that central management and control was the appropriate test for trust residence at common law, and that the trusts were residents of Canada. Although this was sufficient to dispose of the appeal, the Federal Court of Appeal went on to reject the Tax Court of Canada's determination that the deeming rule did not apply to the property transferred in this case, but agreed with the Court's conclusion that because the trusts would not be fully liable for tax as required under Article IV(1) of the Convention, deemed residents were not residents of Canada for treaty purpose.

Issues

- 1) Were the trusts resident of Canada under the common law?

- 2) Were the trusts deemed residents of Canada and would that determination be sufficient to make the trusts Canadian residents for treaty purposes?
- 3) Should the General Anti-Avoidance Rule apply to deny tax benefits under the treaty?

Court Decision

The Supreme Court of Canada reviewed the similar asset acquisition, management, and income distribution functions of trusts and corporations, their common need for legal and financial advisors, and the benefits of a consistent common law residence test for corporations and trustees, amongst other factors. The Court then agreed with the Tax Court of Canada and the Federal Court of Appeal that the residence of a trust is not necessarily where the trustee is resident. Instead, the trust's residence is where its central management and control is exercised, and in this case that was in Canada.

The Supreme Court of Canada declined to comment on the Minister's alternative arguments that the trusts were deemed residents or that the General Anti-Avoidance Rule applied. The Court specified, however, that it should not be understood as endorsing the Federal Court of Appeal's analysis on those issues.

Decision in Favour of

Her Majesty the Queen

Editor's Notes

The case established that the common law residence test for trusts is central control and management, the same common law test that is used to determine corporate residence.

Language of Decision

English and French

Full Text of Decision

In English:

[Supreme Court of Canada](#) or [CanLII](#)

In French:

[Supreme Court of Canada](#) or [CanLII](#)