

Case Name

Canada v. Sommerer, 2012 FCA 207

Countries

Country of decision

Canada

Other countries

Austria

Court

Federal Court of Appeal

Case Number

Docket A-188-11

Parties

Name

Her Majesty the Queen

Role

Appellant

Name

Peter Sommerer

Role

Respondent

Date of Decision

2012-07-13

Treaty Article(s) and Paragraph(s)

Treaty

Canada-Austria Income Tax Convention

Subject

Gains from the Alienation of Property other than those listed in paragraphs (1) – (4)

Sign year

1976-12-9

Last amending protocol (sign date yyyy-mm-dd)

1999-06-15

Article

Article XIII

Paragraph

5

Taxable years

1996 to 2000

OECD Equivalent article(s) and Paragraph(s)

Article

Article XIII

Paragraph

5

Keywords

Trusts; beneficiaries; attribution rules; tax treaties; characterization of foreign entities; Austrian private foundation.

Summary of Facts

An Austrian private foundation (the “Foundation”) was established by the taxpayer’s father, an Austrian resident, naming the taxpayer and his wife as the ultimate beneficiaries. The taxpayer was a resident of Canada throughout the periods in question.

On two different occasions, in 1996 and in 1998, the taxpayer sold shares to the Foundation at fair market value, which the Foundation then sold to third parties, realizing a capital gain.

The Minister reassessed the taxpayer, asserting that subsection 75(2) applied to attribute the capital gain to the taxpayer. Subsection 75(2) attributes any capital gain or loss upon disposing of trust property, or any income or loss resulting from the use of trust property, to the person who transferred the property to the trust.

One of the issues before the Tax Court of Canada was the proper characterization of the Foundation. The Minister argued that the Foundation was a trust, while the taxpayer argued that it was a corporation. The Tax Court of Canada concluded that the Foundation was best characterized as a corporation holding property in trust.

The Tax Court of Canada concluded that subsection 75(2) did not apply to the capital gain realized when the Foundation sold the shares. In the alternative, the Court asserted that under Article XIII(5) of the Canada-Austria Income Tax Convention, Austria has the exclusive jurisdiction to tax the Austrian resident Foundation's capital gains. Canada is therefore precluded from taxing those same capital gains attributed to a Canadian resident.

Issues

- 1) Did the Tax Court of Canada err in concluding that the taxpayer could not be taxed under the attribution rule in subsection 75(2) for the Foundation's capital gains realized on disposition of the shares?
- 2) Did the Tax Court of Canada err in concluding that, in the alternative, Canada was precluded from taxing the respondent on the Foundation's capital gains under Article XIII(5) of the Canada-Austria Income Tax Convention?

Court Decision

The Federal Court of Appeal dismissed the appeal. First, the Court noted that it doubted the correctness of the Tax Court of Canada's characterization that the Foundation was a corporation holding the property in trust, but since it was not an issue in appeal, it would not comment further.

After reviewing the attribution rule in subsection 75(2), the Court asserted that the rule was designed to prevent the avoidance of tax where a taxpayer transfers property in trust while maintaining reversion or disposition rights over the property or its substitute. The Court concluded that Parliament could not have intended subsection 75(2) to apply to situation as in this case, where the beneficiary sold the property to the trust at fair market value. The Court's conclusions regarding the inability to apply subsection 75(2) were sufficient to dispose of the appeal, but the Court went on to agree with the Tax Court of

Canada's conclusion that Article XIII(5) gave Austria the exclusive jurisdiction to tax the Foundation's capital gains upon disposition of the shares, thereby preventing Canada from taxing Mr. Sommerer on the same capital gains attributed to him under subsection 75(2). The Court went on to comment, *in obiter*, that the Minister's argument would require ignoring the key purpose of the treaty, namely to avoid double taxation, whether juridical or economic.

Decision in Favour of

Peter Sommerer, Respondent

Editor's Notes

This decision is of particular interest because of the Court's comments on the goal of tax treaties to avoid both economic and juridical double taxation, as well as the Court's brief reflections on the proper characterization of foreign entities. The Court's decision regarding the function of a domestic attribution rule may also be of interest.

Language of Decision

English and French

Full Text of Decision

In English:

[Federal Court of Appeal's website](#) or [CanLII](#)

In French:

[Federal Court of Appeal's website](#) or [CanLII](#)