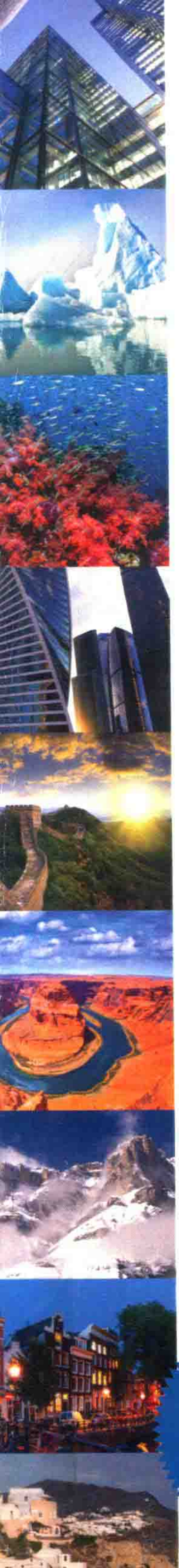

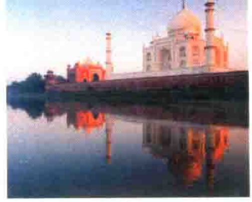

INTRODUCTION TO INTERNATIONAL TAX IN CANADA

3rd edition

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In collaboration with
Julie Robson and
Marie-Pierre Allard

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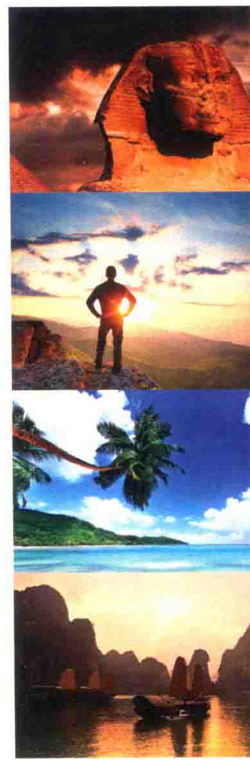

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Jean-Pierre Vidal

PREFACE

The title, "Introduction to International Tax in Canada," is intended to reflect the idea that this book acts as a gateway in a journey through the field of international taxation, an area that is sometimes complex and demanding. In our time, no one can claim that it is enough to read the *Income Tax Act*[1] in full and understand its content. The challenges are too many. First, the purpose of a particular provision is not always clear from the text; second, the order of the provisions sometimes follows a logic that does not promote their understanding; third, a multitude of details are often intermingled in the same place making it difficult to perceive the essential; and fourth, a tax rule remains somewhat obscure until applied. Obviously, one can understand the ITA through careful study of the doctrine found in the databases. But it is a path that can be long and arduous because a large number of the texts examine in detail very specific topics without having a pedagogical approach and without always being current. A good synthesis, advanced enough to be worthy of a graduate course, remained to be written. This is the work that continues in the third edition of this book. New chapters will be added in time.

This year, I welcome Candace Marriott who has just joined our team and who wrote a long-awaited chapter about U.S. transfer pricing (including case studies and recommended solutions).

I would also like to feature Marwah Rizqy who offered us two new key chapters. The first one is about the history of tax treaties, a chapter that is particularly interesting to understand the current state of the law in this matter. The second one is an introduction to U.S. tax. This introduction is particularly useful, because it exposes in a few pages what a Canadian tax specialist should absolutely know about U.S. tax. Finally, Marwah added case studies to her chapter about e-commerce.

1. R.S.C. 1985 (5th Supp.), c. 1 (hereinafter the "ITA").

The format of this book is to address the problems one by one. First, the fundamental objectives that a government may choose are stated clearly with the principles that exist to achieve them. Of course, all governments do not pursue exactly the same objectives and they do not use the same principles in the same circumstances, but most do choose objectives and principles from a limited set of possibilities. Second, when necessary, the order in which the provisions should be read is indicated. It is particularly important to follow this order, especially to understand foreign affiliates' rules. Third, the descriptions in this book could be considered popularizations or summaries of official texts. This popularization is intended to extract their essence. As a result, many details are missing. This book does not replace the official texts, and it does not function as a tax opinion. It is a learning tool and a companion reader. It helps one read and understand the actual law so that the reader can formulate his or her own opinions based on it. Fourth, practical case studies are provided to enable the reader to apply what he learns. Solutions may be seen as suggestions to be used in a learning context.

This book takes the position that there exists a tax reality which is made up of the law, court cases, and administrative positions and actions. Observations of this reality allow for a tax specialist to conceive of a "model" to establish causes and consequences as well as to predict how tax officials and courts will react. This "model" or "theory" of reality is a "hypothesis" until tested. This "model," "theory," or "hypothesis" is called an "interpretation" by legal specialists. In our view, this approach corresponds to a science.

The science of taxation has always existed, but few have recognized it. Some will then suppose that for a science to exist there must be experimentation. This is true—and it is precisely one of the main points that support the idea that there exists a science of taxation. In taxation, an experiment is performed when an interpretation is submitted to an audit or to a court. The stakes in tax experiments are high, and the number of tax experiments is reflected by the number of litigations. But how can there be a science of taxation?

The dictionary tells us that the word "science" means, "[t]he state or fact of knowing; knowledge or cognizance of something specified or implied."[2] Obviously, a body of knowledge exists about taxation—not only about taxation from the point of view of economic science (consequences of taxation in the economy, optimal taxation, etc.), but a body of knowledge from the point of view of the taxation science itself, which exists in order to understand the complex rules that have been devised by governments and to understand the interactions or relationships amongst these rules. Some will then think that for a science to exist, the singular existence of a body of knowledge is insufficient. There must also be a method of discovery.

In the recognized branches of science, mathematical models are designed to accurately resemble or represent a reality in order to understand it and make predictions. The value of any given model is then established by using empirical tests to verify if it explains and predicts the reality correctly. The same sort of approach exists in taxation (as it does in the legal field in general), but the terms are not the same. A scientist calls her representation of reality a model and she develops it with equations (a type of language). A tax specialist calls his representation of reality an interpretation. A scientist calls his tests "experiments." A tax specialist calls his tests "litigations." A chemist seeks to predict how two elements will react. A tax specialist wants to predict how tax officials and the courts will react.

Some will then say that there is nothing to discover in taxation for this law is written down in a book that can be easily opened and read. This is a mistake. The truth about taxation is that it is written with words which are much less precise than equations. As a result the meaning of these words often does have to be found, as do the interactions between extremely complex rules. In many circumstances, a tax specialist has no choice but to build his own interpretation (a model of the tax reality) and sometimes his interpretation is put to the test (during an audit or in court). This is science not art. This is a process by which the tax reality is discovered.

It may seem odd that the human race has written something that is so complex with words that are so imprecise that people do not fully understand all of what has been written. However, this is what sometimes happens in tax. The meaning of the law has to be

2. See *Oxford English Dictionary*, *OED Online* (March 2013, Oxford University Press), *sub verbo* "science, n.".

discovered and rediscovered in different contexts and no one knows exactly what the tax reality is in a difficult context until it has been tested.

Some then might doubt that litigation can be a test from a scientific perspective, for they view the decision of a court as something "subjective." This objection does not hold water for two reasons. First, it is easy to see in any academic journal that scientific debates are frequent and that researchers do not always arrive at the same results or conclusions. The fact that a judicial decision can be reversed by another is simply the equivalent of two different papers reporting contradictory empirical results. There is no science where everybody agrees all the time. Second, the subjective nature of a decision, in the sense that it comes from a human being, does not discredit the value of the legal test. The world of taxation is created by human beings to regulate the behaviour of human beings. It is therefore normal that the verdicts be given by human beings (and that the experiments consist of observing the decisions of human beings). A court decision is no less a fact verifiable by all observers, and therefore, it is an objective fact.

This book is not a "research" book. It is a "pedagogical" book. This book does not pretend to contribute to the discovery of new interpretations. However, it does seek to guide a tax specialist in the discovery of a small part of the tax reality. She will then be able to build her own interpretations/models/hypotheses based on observing the tax reality (the law, the jurisprudence, and the administration positions and actions).

It is with pride that this book is presented in its third edition. It contains a quantity of material covering fundamental subjects; the fourth edition is expected to include more chapters to account for areas not dealt with in the following pages.

Jean-Pierre Vidal

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Marwah also holds a Bachelor degree in Law and a Master of Business Administration (LL.B./MBA) from the University of Sherbrooke. Marwah is a member of the Barreau du Québec and New York Bar Association, the Association de planification fiscale et financière, the Canadian Tax Foundation, and the International Fiscal Association. She teaches in the Masters in Taxation program in Sherbrooke and Longueuil courses entitled "International Taxation" and "American Taxation." In addition, she also teaches, at the J.D. level, an introductory course in taxation entitled "Tax Law."

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