Tax Treaty Case Law around the Globe 2013
Why this book?

Tax Treaty Case Law around the Globe 2013 comprises the proceedings of a conference held in Vienna, Austria on 23-25 May 2013. The book provide a unique and comprehensive global overview of international tax disputes on double tax conventions, thereby filling a gap in the area of tax treaty case law. It covers the 36 most important tax treaty cases that were decided around the world in 2012. The systematic structure of each case allows easy and efficient comparison of the varying application and interpretation of tax treaties under different regimes.

With the continuously increasing importance of tax treaties, Tax Treaty Case Law around the Globe 2013 is a valuable reference tool for anyone interested in tax treaty case law. This book is of interest to tax practitioners, multinational businesses, policymakers, tax administrators, judges and academics.

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Individual Residence Under the Canada – U.S. Tax Treaty: Trieste v. The Queen

David G. Duff

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1. Introduction

Where an individual is determined to be a resident of two states, Article 4(2) of the OECD Model Convention stipulates that the conflict is to be resolved by a series of tiebreaker rules, considering the location of permanent homes that are available to the individual, as well as the individual’s personal and economic relations (centre of vital interests), habitual abode, and nationality, before delegating the issue to the competent authorities to determine the individual’s residence by mutual agreement. Although the Model Convention does not define the terms permanent home, centre of vital interests, or habitual abode, the OECD Commentary on Article 4(2) contains several paragraphs on the meaning of these concepts. Judicial decisions involving tax treaties based on the OECD Model Convention provide further guidance on the application of these tiebreaker rules.

Trieste v. The Queen involved the tiebreaker rule in Article IV(2) of the Canada – US Treaty. Although this treaty differs slightly from the OECD Model, considering the individual’s centre of vital interests both where the individual has a permanent home in neither state as well as where the individual has a permanent home in both states, it employs the same terms as Article 4(2) of the OECD Model. As a result, the Commentary on the OECD Model should be relevant to the interpretation of terms like “centre of vital interests” and “habitual abode” in the Canada – US Treaty, and judicial interpretations of these concepts under the Canada – US Treaty should be relevant to the interpretation of these terms under other tax treaties based on the OECD Model. While the facts in Trieste provide a textbook opportunity to consider the treaty tie-breaker rules for individual residents, this contribution disagrees with the court’s conclusions.

2. Facts of the Case

The facts in Trieste are lengthy, but straightforward. The taxpayer was a US citizen who had worked for many years at nuclear power plant facilities throughout the United States. Prior to coming to Canada, he had worked for five years on a contract basis for Onsite Engineering & Management Inc. (Onsite), at nuclear facilities in Colorado and Oak Ridge, Tennessee, where he lived. On July 2, 1999, the taxpayer and his wife purchased a house in Oak Ridge.

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1 Organization for Economic Cooperation and Development, Commentaries on the Articles of the Model Tax Convention, Commentary on Art. 4, paras. 9-20.
2 2012 TCC 91, aff’d 2012 FCA 320 [hereafter Trieste].
3 In the OECD Model Convention, the individual’s centre of vital interests is considered only if the individual has a permanent home available to him or her in both states. If the individual does not have a permanent home in either state, the OECD Model Convention turns to the individual’s habitual abode.
4 Contra Allchin v. The Queen, [2005] CTC 2701, 2005 DTC 603 (TCC), at para. 52 (in which the court stated that the OECD Commentary on the meaning of “habitual abode” is “not useful” in interpreting the Canada – US Treaty).
On April 30, 1999, the taxpayer was engaged by Onsite to perform work for Ontario Power Generation (OPG) in the Canadian Province of Ontario. Although this contract was to last for 18 months, a new agreement was entered into on January 1, 2000, according to which the taxpayer would provide engineering and management services to OPG for an indefinite period on a boiler cleaning project at its Pickering nuclear generating station, near Toronto.

The taxpayer shared a rented condominium with two other individuals who had previously worked at Oak Ridge when he first moved to Canada in May 1999, but purchased a condominium near Pickering after the new agreement was entered into in 2000. Although he sold this condominium in December 2000, he purchased another the same month, which he held throughout the years at issue. During this time, the taxpayer and his wife also retained their home in Oak Ridge, Tennessee, which remained available to them at all times and was where they kept most of their personal effects. While the taxpayer’s wife stayed with him in Canada from time to time, she appears to have lived mainly at the couple’s home in Oak Ridge, to which the taxpayer returned once a month and on holidays.

When in Tennessee, the taxpayer saw family and friends and pursued “his main hobby, skeet shooting, through his gun club membership in Tennessee.” In Canada, on the other hand, the taxpayer “had a couple of friends from work with whom he shared common interests, such as skiing and biking.”

The taxpayer became eligible for health insurance in Ontario from November 2003 to December 2005, but also maintained health coverage in Tennessee. Throughout the years at issue, his car was registered in the United States and he used his US driver’s licence. He also retained US investments, credit cards, and bank accounts, to which his remuneration from Onsite was deposited directly, though he also set up a personal bank account in Canada, as well as a mortgage account for the condominium, and obtained one Canadian credit card.

Although the taxpayer filed US tax returns during this period, he claimed the foreign earned income exclusion on the basis that his tax home was in Canada in 2001, 2002 and 2003. At the time, this provision permitted US citizens whose “tax home” was in a foreign country to exclude up to USD 80,000 of foreign earned income from US income tax. For the purpose of this provision, the US Internal Revenue Service regards an individual’s tax home as “the general area of [the individual’s] main place of business, employment or post of duty, regardless of where [the individual] maintains a family home.” It also explains that an individual is “not considered to have a tax home in a foreign country for any period in

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5 Trieste, supra note 2, TCC at para. 11.
6 id. at para. 12.
7 Internal Revenue Code, § 911.
which [the individual’s] abode is in the United States” – defining an “abode” as “one’s home, habitation, residence, domicile or place of dwelling” and explaining that the location of one’s abode often depends on where one maintains one’s “economic, family and personal ties.”9 As a result, the US concept of a tax home is similar to the tax treaty concept of a taxpayer’s centre of vital interests, though its primary focus on the individual’s main place of business or employment suggests that it tends to emphasize the individual’s economic relations more than his personal relations.

When the contract with OPG ended in 2005, the taxpayer returned to Tennessee. At trial, he testified he had no intention of staying in Canada after the contract ended, and “kept sending out résumés to various companies in the US” during the time that he was working in Canada “in an attempt to get back with his family.”10

The taxpayer was assessed as a deemed resident under Paragraph 250(1)(a) of the Income Tax Act,11 on the basis that he had sojourned in Canada for at least 183 days during each of the years 2000, 2001, 2002 and 2003, and was therefore taxable in Canada on his worldwide income for each of these tax years. In response, the taxpayer claimed that he was a resident of the United States and not Canada under Article IV(2) of the Canada – US Treaty and subsection 250(5) of the ITA, which deems a person not to be resident in Canada if the person would otherwise be a resident of Canada but is deemed under a tax treaty with another country to be a resident of the other country and not a resident of Canada.

3. The Court’s decision and comments on the Court’s reasoning

Since it was agreed that the taxpayer had a permanent home available to him in Canada and the United States throughout the taxation years at issue, the case turned first on the taxpayer’s centre of vital interests and, if this could not be determined, on the taxpayer’s habitual abode. The court held that it could not decide with which country the taxpayer’s personal and economic relations were closer,12 and that the taxpayer’s habitual abode during this period was in Canada.13 This decision was upheld on appeal on the basis that the tax court’s determinations were questions of fact that should not be reversed in the absence of palpable and overriding errors, which the court of appeal did not find. The following sections explain the tax court’s reasons and argue that its conclusions involved mixed questions of fact and law that the federal court of Appeal ought to have reversed.

9 id.
10 Trieste, supra note 2, TCC at para. 14.
11 R.S.C. 1985, c. 1 [as amended].
12 Trieste, supra note 2, TCC at para. 25.
13 id. at para. 30.
3.1. Centre of Vital Interests

According to the OECD Commentary, in order to ascertain the state with which an individual’s personal and economic relations are closer, it is necessary to consider the individual’s circumstances “as a whole,” having regard to factors such as the individual’s family and social relations, occupations, political, cultural or other activities, place of business and administration of property, and paying “special attention” to “personal acts of the individual”. In addition, the OECD Commentary emphasizes:

*If a person who has a home in one state sets up a second in the other state while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first state.*

In *Trieste*, the taxpayer maintained numerous personal and economic relations in the United States during the time that he was working and living in Canada – family and friends, particularly his wife who lived mostly at the home in Oak Ridge where he kept most of his personal effects, membership in a gun club, health insurance, car registration and driver’s licence, investments, credit cards and bank accounts to which his remuneration was deposited. Although his sole source of income during this period was from the contract with OPG, this contract was negotiated with a US company, Onsite, for which he had worked for several years, and the other personal and economic relations that the taxpayer developed in Canada while living there were closely connected with his work in Canada – “a couple of friends from work with whom he shared common interests”, the purchase of a condominium near his place of work, and bank accounts and a credit card to manage personal expenses and a mortgage on the condominium.

In these circumstances, taking into account the OECD Commentary and especially the quoted sentence above, one might have thought that the court would conclude that the taxpayer’s personal and economic relations during these years were closer to the United States than Canada. Indeed, the taxpayer made this argument at trial, relying on the Tax Court of Canada’s earlier decision in *Gaudreau v. The Queen*, in which the same judge held that a Canadian citizen who lived and worked in Egypt for four years maintained closer personal and economic relations with Canada than Egypt, notwithstanding that his wife moved with him and returned to Canada only twice in the summertime for 2-3 weeks, on the grounds that he and his wife kept their house and all their possessions in Canada, their family lived in Canada, they never intended to give up their economic and

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14 Commentary on Art. 4, para. 15.
15 id.
16 2004 TCC 840, aff’d 2005 FCA 388.
personal relations with Canada, and the taxpayer “did not really maintain any economic relations with Egypt apart from those he needed to have in order to meet his day-to-day living expenses.” 17 Further support for this position might be derived from another Tax Court of Canada decision in which the court emphasized that an inquiry into an individual’s centre of vital interests should place greater emphasis on “the depth of the roots of one’s centre of vital interests” more than “the number of factors or connections on each side.” 18

Distinguishing her prior decision in Gaudreau, however, Lamarre J. held that it was “not possible to determine the country with which the appellant had closer personal and economic relations ….” 19 On the contrary, she explained:

*Here, the appellant testified that he had relocated himself and his family many times in the past. His home in Tennessee was purchased in July 1999, that is, after he first came to Canada under his first contract with Onsite to work in Pickering, Ontario. In Gaudreau, the taxpayer and his wife were Canadian citizens who owned the paternal house inherited from the wife’s parents in Canada. The taxpayer did not purchase a property in Egypt, the country where he was assigned work, while the appellant in the present case purchased two condominiums during his assignment in Canada, and we know that on one of these he made a capital gain. The appellant also had social relations and activities in Canada.* 20

Although not referring specifically to the sentence from the OECD Commentary quoted above, one can infer from this passage that the judge concluded that it did not apply to Mr. Trieste because the Oak Ridge home that he retained while living in Canada was not “in the environment where he *always* lived” [emphasis added] – since he had lived at various locations throughout the United States while working at nuclear power plants in different locations and purchased the Oak Ridge home only in July 1999, “after he first came to Canada under his first contract with Onsite to work in Pickering, Ontario.” Whether the sentence in the OECD Commentary was meant to be read so narrowly is doubtful.

Since the taxpayer consistently lived in the United States before he moved to Canada to work at OPG, acquired the Oak Ridge home shortly after the entering into an 18-month contract to work at OPG, retained this home throughout the period that he lived in Canada, left most of his possessions at the Oak Ridge home, and returned to this home on a regular basis to see his wife who appears to have stayed there for most of the time that he was living in Canada, it seems both rigid and formalistic to conclude that he did not retain his centre of vital interests in the

17 id., TCC at para. 39.
19 *Trieste*, supra note 2, TCC at para. 25.
20 id. at para. 24.
United States because he did not acquire the Oak Ridge home before he started working in Canada. On the contrary, although the taxpayer purchased a condominium to live in Canada, and had “a couple of friends from work with whom he shared common interests,” it appears that his personal and economic relations in Canada were not unlike those of Mr. Gaudreau in Egypt, and much lesser in one important respect since his wife generally remained at the home in Oak Ridge. Considering both the number as well as the depth of the roots of his connections in Canada and the US, therefore, it seems difficult to conclude that the taxpayer’s personal and economic relations were not closer to the US than they were to Canada. As a result, the court’s conclusion that it was not possible to determine the country with which the taxpayer had closer personal and economic relations seems unsupported on the facts, suggesting that the court either misapplied the proper legal test for assessing an individual’s centre of vital interests or made a palpable and overriding error in applying this test to the facts of the case. On either basis, the federal court of appeal ought to have reversed the tax court’s conclusion on appeal.

3.2. Habitual Abode

Where an individual has a permanent home in both states and it is impossible to determine the state with which the individual’s personal and economic relations are closer, the OECD Model stipulates that the individual shall be deemed to be a resident of the state in which he or she has an habitual abode. In this circumstance, the OECD Commentary explains, “the fact of having an habitual abode in one state rather than in the other appears … as the circumstance which … tips the balance towards the state where [the individual] stays more frequently.”21 In addition, it explains, although the OECD Model Convention “does not specify over what length of time the comparison must be made” between periods of residence in each state, “[t]he comparison must cover a sufficient length of time for it to be possible to determine whether the residence in each of the two states is habitual and to determine also the intervals at which the stays take place.”22

Although neither the OECD Model Convention nor the OECD Commentary defines the concept of an habitual abode, courts and commentators have referred to dictionary definitions and the French version of the OECD Model Convention in order to give meaning to this term. According to John Avery Jones et al., the combination of the noun “abode” with the adjective “habitual” suggest that an “abode” should be understood as the “concept of residing”, which is confirmed by the French version, où elle séjourne de façon habituelle, meaning where one stays in an habitual way.23 In turn, the word habitual is defined as “customary,

21 Commentary on Art. 4, para. 17.
22 id. para. 19.
usual, of the nature of a habit”, suggesting that an habitual abode is where one resides usually or customarily. As a result, as Avery Jones et al. conclude, “by using the expression ‘habitual,’ what is meant is whether living in each state is normal.”

While the OECD Commentary appears to suggest that the characterization of an habitual abode is inherently comparative, identifying the state in which the individual “stays more frequently”, a careful reading of this passage in the OECD Commentary indicates that this consideration applies only where an individual has a permanent home in both states and “an habitual abode in one state rather than the other.” In this circumstance, as the Tax Court of Canada explained in *Lingle v. The Queen*, “the individual will stay more frequently in the place where he has his sole habitual abode.”

As a result, as Avery Jones et al. explain, instead of asking in which state the individual’s abode is more habitual, “the correct way of applying the test is to ask of each state whether the taxpayer has an habitual abode there, just as one asks whether he has a permanent home.” This approach, they emphasize, best accounts for the subsequent tiebreaker rule where an individual “has an habitual abode in both states,” and makes most sense of the statement in the OECD Commentary that “[t]he comparison must cover a sufficient length of time for it to be possible to determine whether the residence in each of the two states is habitual ….” It is also most compatible with the main purpose of the tiebreaker rules to “reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular state.” For these reasons, as the federal court of appeal emphasized in *Lingle*, the concept of an habitual abode “refers to a stay of some substance in the jurisdiction as a matter of habit, so that the conclusion can be drawn that this is where the taxpayer normally lives.”

From this perspective, one might have thought that the tax court in *Trieste* would have concluded that the taxpayer had an habitual abode in both Canada and the United States — at his condominium in Canada where he stayed frequently and regularly when working at OPG in Pickering, and at his Oak Ridge home in the United States where he stayed less frequently but no less regularly when he

26 2009 TCC 435, aff’d 210 FCA 152 [hereafter *Lingle*].
27 id. para. 22.
29 OECD Model Convention, Art. 4 para. 2 let. c.
30 Commentary on Art. 4, para. 19 [emphasis added].
31 Commentary on Art. 4, para. 10.
32 supra note 26.
33 id. para. 6.
returned each month and on holidays, and to where he returned permanently when the OPG contract came to an end. On this basis, the court would have turned to the subsequent tiebreaker rule, deeming the taxpayer to be a resident of the United States on the basis of his US citizenship.

Although accepting that the proper test for determining whether an individual has an habitual abode in a state is to ask whether the individual resided “regularly, customarily or usually” in that state, the court nonetheless held that Mr. Trieste had an habitual abode in Canada and not the United States on the basis that “his settled routine was, during the years at issue, in Canada and not in the United States” – even though he “returned periodically – once a month and for holidays – to the United States” According to Lamarre J., “the appellant spent a lot more time in Canada, did not work elsewhere during that period, and in the settled routine of his life, regularly and customarily lived in Canada while periodically returning to the United States” As a result, it would seem, the tax court applied a comparative test to conclude that the taxpayer had an habitual abode in Canada largely on the basis that he spent more time in Canada than in the United States – despite the fact that he regularly returned to the United States, where he had consistently resided prior to his contract with OPG and to which he returned once this contract concluded.

Whether this conclusion is consistent with the concept of an habitual abode and purpose of the tiebreaker rules to “reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular state” is doubtful. That this conclusion turned on the court’s understanding of the law as well as the facts is indisputable. For these reasons, this part of the tax court decision should also have been reversed on appeal.

4. Conclusion

Although this contribution argues that the tax court decision in Trieste misconstrued and misapplied the tiebreaker rules in Article IV(2) of the Canada – US Treaty, it is important to recognize two additional factors that may have influenced the court. First, to the extent that the Canadian revenue authorities appear to have regarded Mr. Trieste as an independent contractor without a fixed base or permanent establishment in Canada, a determination that he was a resident of Canada under the Canada – US Treaty was the only way in which Mr. Trieste could have been subject to Canadian tax on substantial Canadian source income that was earned over several years. Second, by claiming a foreign earned income exclusion from 2001 to 2003, the taxpayer himself declared that his tax home was in Cana-

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34 *Trieste*, supra note 2, TCC para. 30.
35 id.
36 id.
da during these years, as a result of which USD 80,000 of his Canadian source income for each of these years was exempt from tax in the United States.

On the first point, it is unfortunate that the Canada Revenue Agency (CRA) did not assess Mr. Trieste either as an employee whose income could have been subject to tax in Canada under Article XV (Income from Employment) of the Canada – US Treaty, or as having a fixed base or permanent establishment in Canada so that his Canadian source income could have been subject to tax in Canada under former Article XIV (Independent Personal Services) or Article VII (Business Profits) of the Canada – US Treaty. Although the CRA may have been reluctant to assess Mr. Trieste on either of these grounds on account of previous Canadian tax cases in which taxpayers have succeeded on each of these issues, the facts may have supported the conclusion that Mr. Trieste was an employee or that his services were carried on through a fixed base or permanent establishment in Canada. Regardless, the absence of proper source taxation in Canada is a questionable basis on which to interpret the Canada – US Treaty to ensure that a taxpayer with Canadian source income is subject to Canadian tax on the basis of the tiebreaker rules for individual residence. To the extent that Canada’s source rules are inadequately drafted or interpreted, the proper response is to amend these rules – as was done with the addition of a services permanent establishment concept in the Fifth Protocol to the Canada – US Treaty.

On the second point, it is important to recall that the US test for an individual’s tax home is not identical to the treaty tiebreaker rules, emphasizing as it does economic relations more than personal relations. As a result, it does not follow from the fact that Mr. Trieste claimed a foreign earned income exclusion in the United States that he should be regarded as a resident of Canada under the tiebreaker rules in Article IV(2) of the Canada – US Treaty. On the contrary, availability of the foreign earned income exclusion in the US is as consistent with source-based taxation in the foreign country that is the individual’s tax home as it is with residence-based taxation. Regardless, to the extent that non-taxation of a portion of Mr. Trieste’s Canadian source income is considered inappropriate (e.g., on the basis that it results in double non-taxation), responsibility for this result appears to rest with the US, which does not make the foreign earned income exclusion conditional on taxation in the source state. For this reason, too, the fact that Mr. Trieste claimed the foreign earned income exclusion in the US is a questionable basis on which to conclude that he was resident in Canada under Article IV(2) of the Canada – US Treaty.

37 See, e.g., Wolf v. The Queen, 2002 FCA 96 (holding that the taxpayer was an independent contractor); and Dudney v. The Queen, [2000], 2 C.T.C. 56 (FCA) (concluding that the taxpayer did not have a fixed base in Canada).
39 supra, text accompanying note 8.
Finally, the tax court’s confusion on the application of the habitual abode test, which it appears to have incorrectly interpreted as a comparative test, might suggest some changes to the OECD Commentary on Article 4(2), which does not define the concept of an habitual abode, appears to suggest that an individual may have an habitual abode in the state in which the individual “stays more frequently”, and explicitly refers to a “comparison” of the length of time that the individual stays in each place. Where the OECD Commentary is not clear, it is not entirely surprising that judicial decisions that attempt to rely on it will also be unclear. In addition to whatever other factors influenced the tax court’s conclusions in Trieste, ambiguities in the OECD Commentary may also have played a role.

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40 Commentary on Art. 4, para. 17.
41 id. para. 19.
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