
Trust Residence After Garron: Provincial Considerations

H. Michael Dolson*

PRÉCIS

Les décisions récentes dans l'arrêt *Garron* et l'adoption du critère de gestion centrale et de contrôle pour déterminer le lieu de résidence d'une fiducie pourraient avoir une incidence importante sur la planification fiscale entre provinces, ne serait-ce que pour le projet de vérification de l'ARC en résultant qui vise les fiducies résidentes de l'Alberta. Le présent article examine les fondements théoriques de l'instauration d'un impôt provincial sur le revenu de fiducie basé sur le lieu de résidence et propose au moins une solution de rechange acceptable, mais imparfaite. L'article examine ensuite le thème du centre de gestion et de contrôle des fiducies et traite de la façon dont ce critère pourrait être appliqué dans des causes futures.

ABSTRACT

The recent decisions in *Garron* and the adoption of the central management and control test for trust residence may have a material impact on interprovincial tax planning, if for no other reason than the resulting CRA audit project targeting Alberta-resident trusts. This article examines the theoretical basis for the imposition of residence-based provincial income taxes on trust income, revealing at least one acceptable but nevertheless flawed alternative. This article then turns to an examination of central management and control in the context of trusts, and discusses how this test could be applied in future cases.

KEYWORDS: TRUSTS ■ RESIDENCE ■ PROVINCIAL TAXES

CONTENTS

Introduction	672
Provincial Income Taxes—Policy and Efficiency	673
Policy Considerations—Individuals	675
Policy Considerations—Trusts	677
Conceptualizing the Trust and Alternatives for Taxation	677
The Current System and Residence Taxation	679
The Downside of Residence Taxation and Reconsidering Alternatives	680

* Of Felesky Flynn LLP, Edmonton (e-mail: mdolson@felesky.com). I would like to thank Jon D. Gilbert and Timothy P. Kirby of Felesky Flynn LLP, Edmonton, and Tim Edgar of Osgoode Hall Law School and a co-editor of this journal, for their comments on earlier drafts of this article. Any remaining errors or omissions are solely my own.

Residence of Trusts	682
Statutory Provisions	682
Jurisprudence	683
Pre-Garron	683
Garron	687
Central Management and Control	690
The CRA's Audit Program and Dispute Resolution	695
Conclusion	698

INTRODUCTION

Under provincial income tax legislation personal trusts are generally taxed on the basis of the trust's province of residence; therefore, residence is a key determinant of the total tax obligations of a personal trust. Although the taxation of business income earned by personal trusts is source-based, the residence-based taxation of property income is of paramount importance; assuming that personal trusts are as likely as, or less likely than, individuals to carry on a business directly,¹ it is relatively unlikely that a personal trust would earn significant business income.² In most instances, the source of this business income will be in the same province as the trust's place of residence. Consequently, the rate of provincial income tax applied to the income of a personal trust will, in substantially all cases, depend entirely on the residence of the trust.

In my view, a review of the literature and jurisprudence discussed in this article allows the following conclusions to be drawn with respect to the residence of trusts for the purposes of provincial income tax:

- Although personal trusts are deemed to be individuals for the purposes of the Income Tax Act (Canada) and its provincial equivalents,³ the policy considerations relating to the place of residence of natural persons are not the same as

1 Where a personal trust carries on a business, the trustees will likely be treated as carrying on the business of the trust as principals: *Smith v. Anderson* (1880), 15 Ch. D. 247, at 275-76 (CA). If a personal trust carries on a business, the trustees may therefore be exposed personally to the business liabilities of the trust. Such exposure serves as a significant disincentive to the use of a personal trust as a business vehicle. In the income tax context, the personal liability of trustees is avoided by subsection 104(2) of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Subsection 104(2) provides that the income of the trustee is not affected by the characterization of a trust as an individual, although subsection 159(3) could impose personal liability on a trustee who makes distributions of trust property at a time when the trust is liable for tax. (Unless otherwise stated, statutory references in this article are to the Act.)

2 The Canada Revenue Agency (CRA) does not publish T3 statistics similar to its published T1 and T2 statistics. In 2009, only 7.6 percent of individuals who filed T1 returns reported business income, excluding partnership income, and the average per-return business income was \$12,135: Canada, *T1 Final Statistics—2011 Edition* (2009 tax year) (Ottawa: Canada Revenue Agency, 2011), at final table 3 (www.cra-arc.gc.ca/gncy/stts/gb09/pst/fnl/html/tbl3-eng.html).

3 Subsection 104(2) of the Act; see *infra* notes 34 and 36 for the equivalent provincial legislation.

the policy considerations relating to the residence of personal trusts, which are more analogous to corporations.

- While the central management and control test for residence may be appropriate in the corporate context, it is not clear that this is an appropriate test for determining the residence of a personal trust. The absence of the source-based taxation regime that applies to corporations places significant pressure on the test for residence that is selected, and the central management and control test is prone to manipulation.⁴ A potential alternative would be a test for trust residence that looked to the residence of the settlor (similar to the test currently used for non-resident trusts in section 94 of the Act), although there would be technical issues associated with such a test.
- The central management and control test, as developed by the jurisprudence to date, is not a particularly aggressive test for determining the residence of a personal trust, notwithstanding that tax administrators may attempt to apply the test in this manner. Establishing central management and control of a trust in a particular province should not require anything more than ensuring that significant decisions relating to the property of the trust are made in that province, without regard for the residence of the decision maker.

This article is divided into two parts. In the first part, I review the basis for the imposition of residence-based income taxes on personal trusts by the provinces, and consider potential alternatives. In the second part, I review the rules governing the tax residence of trusts, discuss the recent jurisprudence, and offer some thoughts on how the central management and control test should be applied.

PROVINCIAL INCOME TAXES—POLICY AND EFFICIENCY

The reason that the provinces impose personal income taxes, including the income taxes imposed on a personal trust, is obvious: provincial governments require the funds. Pursuant to section 92 of the Constitution Act, 1867,⁵ the provinces have responsibility for some of the most expensive functions of government, including health care, education, and the administration of justice. In order to fund these

4 For a discussion of the problems created by the central management and control test and its susceptibility to manipulation in the corporate context, see Brian J. Arnold, “A Tax Policy Perspective on Corporate Residence” (2003) 51:4 *Canadian Tax Journal* 1559-66. In the international context, the central management and control test is replaced (except for the purposes of regulation 5907(11)) by Canada’s tax treaties and subsection 250(5) of the Act, which usually resolve conflicts relating to corporate residence on the basis of the place of incorporation. Ultimately, for a multinational corporation operating in Canada, the source-based taxation of business profits, the enactment of the foreign accrual property income regime, and the decision not to tax business profits earned by non-resident subsidiaries significantly reduce the impact of residence in determining the corporation’s liability for Canadian tax.

5 Constitution Act, 1867, 30 & 31 Vict., c. 3.

public goods, the provinces are entitled to impose direct taxes and to borrow money on their own credit.⁶ Personal income tax is a direct tax that generates significant revenues.

In aggregate, in 2009 personal income taxes accounted for 30.22 percent of own-source provincial revenues (revenues excluding transfers from other levels of government).⁷ The degree of reliance on provincial income taxes varies from province to province; for example, Alberta is more reliant on personal and corporate income taxes than Saskatchewan, which (like the other eight provinces) supplements its revenues from income taxes by imposing a general sales tax.

It is generally accepted that provincial personal income taxes are less efficient than federal personal income taxes (as measured by the marginal cost of public funds), and are also less efficient than a general sales tax, particularly a value-added tax.⁸ Provincial taxes also create negative externalities and may lead to non-optimal policies, to the extent that provinces compete with one another in seeking to attract mobile labour and capital.⁹ These externalities and non-optimal policies may include tax exporting, the use of regressive taxes that fall on the non-mobile poor and the elderly, and beggar-thy-neighbour tax competition.¹⁰

The potential negative externalities caused by provincial taxation can be mitigated by ceding the right to tax mobile tax bases, such as income, to the federal government, with the provinces taxing less mobile bases, such as consumption or real property.¹¹ This was the recommendation of the Carter commission with respect to corporate income taxes—specifically, that the federal government provide sales tax room to the provinces in exchange for exclusive federal use of the corporate

6 Section 92(2) of the Constitution Act, 1867. The term “direct tax” (borrowed from John Stuart Mill’s *Principles of Political Economy*) is intended to capture taxes that are ultimately borne by the person on whom the tax is imposed: *Ontario Home Builders’ Association v. York Region Board of Education*, [1996] 2 SCR 929, at paragraphs 34-35. Examples include personal income taxes, sales taxes, and property taxes.

7 Statistics Canada, CANSIM table 385-0002, “Federal, Provincial and Territorial General Government Revenue and Expenditures, for Fiscal Year Ending March 31, 2009.”

8 Bev Dahlby, “Reforming the Tax Mix in Canada” (2012) 5:14 *SPP Research Papers* 1-32, at 10. See also Maximilian Baylor and Louis Beauséjour, *Taxation and Economic Efficiency: Results from a Canadian CGE Model*, Department of Finance Working Paper 2004-10 (Ottawa: Department of Finance, 2004); and Alexandra Bibbee, *Tax Reform for Efficiency and Fairness in Canada*, OECD Economics Department Working Paper no. 631 (Paris: OECD, 2008).

9 For discussion of the economic effects of interprovincial competition, see Robin Boadway, Maurice Marchand, and Marianne Vigneault, “The Consequences of Overlapping Tax Bases for Redistribution and Public Spending in a Federation” (1998) 68:3 *Journal of Public Economics* 453-78.

10 See Robert P. Inman and Daniel L. Rubinfeld, “Designing Tax Policy in Federalist Economies: An Overview” (1996) 60:3 *Journal of Public Economics* 307-34.

11 Robin Boadway, “Inter-Governmental Fiscal Relations: The Facilitator of Fiscal Decentralization” (2001) 12:2 *Constitutional Political Economy* 93-121, at 105-6.

income tax.¹² If the provinces must have access to any base that they can tax directly, it is preferable that they impose tax using residence-based or partially residence-based systems, since this should at least prevent tax exportation.¹³

As discussed in further detail below, all of the provinces have in fact adopted a partially residence-based system for taxing income, with property and employment income being taxed on the basis of residence and business income being taxed on the basis of source. This is a logical choice since, in this respect, the provincial system generally mirrors the system adopted at the federal level: while the Act generally imposes tax on the basis of residence, source-based taxation is used for active businesses carried on outside Canada through foreign affiliates and businesses carried on in Canada by non-residents. Moreover, to the extent that a partially residence-based system prevents tax exportation, it has the potential to be more efficient than systems that do not.

Policy Considerations—Individuals

Notwithstanding that the system adopted may have been a logical choice, it is not unreasonable to question whether a residence-based system for personal income tax remains appropriate in an age of increased labour mobility. While many individual taxpayers will have all of their sources of income in the province in which they are resident, it is not uncommon for individuals to be employed in provinces in which they are not resident for income tax purposes, as a result of increasing regional economic disparities and relatively low-cost (or employer-subsidized) travel. Is it appropriate that these individuals are taxed in their province of residence instead of their province of employment?

The problem with the current system can be illustrated by a simple example. An individual employed in Fort McMurray, Alberta maintains a home in Kelowna, British Columbia, where her family lives and to which she returns during the one or two weeks a month when she is not working. The individual will likely be considered a resident of British Columbia for income tax purposes and, under the partially residence-based system, will pay personal income tax in British Columbia and not in Alberta. Since Alberta does not levy a general sales tax, the Alberta government will not realize any revenue from the individual's consumption of goods and services during the time that she is living and working in the province.

This result would traditionally be justified on the basis that individuals can be assumed to derive more benefits from public goods in the place where they are

12 Canada, *Report of the Royal Commission on Taxation*, vol. 6 (Ottawa: Queen's Printer, 1966), at 214.

13 Inman and Rubinfeld, *supra* note 10, at 318-19. If it is accepted that non-exportation was a reason for the provinces being limited to direct taxation by the Constitution Act, 1867, as Peter Hogg has suggested (Peter W. Hogg, *Constitutional Law of Canada*, 3d ed. (Toronto: Carswell, 1992), at section 30.2(b)), then the adoption of a residence-based tax system by the provinces also furthers constitutional principles.

resident.¹⁴ However, an examination of the benefits received does not necessarily support this conclusion:

- The individual derives benefits from the administration of justice in both British Columbia and Alberta, since her property and physical safety are preserved at the expense of both provinces at various times.
- The individual derives significant benefits from her employment in Alberta. Those benefits are dependent on infrastructure financed by Alberta taxpayers and are also likely to be dependent on natural resources vested in her majesty in right of Alberta.
- If the individual has children, and those children remain in British Columbia, she will derive benefits from the free public education made available to them at the expense of BC taxpayers. The individual's ability to earn employment income may also be attributable to public education or publicly subsidized post-secondary education, which may have been provided at the expense of the BC taxpayers.
- The individual and her family derive benefits from the infrastructure financed by the BC taxpayers, as well as municipal services financed by transfers from the BC government.
- The individual may require access to provincially funded public health care in either Alberta or British Columbia, and her family will receive this benefit in British Columbia. However, it is important to note that nearly half of lifetime health-care expenses are incurred after age 65, and that proportion will likely increase if the individual survives past age 85.¹⁵ As a result, it is possible that the bulk of the individual's benefits from public health care will be received in a province in which the individual is not currently resident or employed.
- The individual may derive benefits from social services provided to senior citizens, but it is not known which province, if any, will be required to fund those services.

Whether this is an appropriate result may depend on how one weighs the various benefits. If emphasis is placed on the benefits from employment that are dependent on public goods provided by Alberta, then it does not seem appropriate that Alberta does not tax the income earned in Alberta or the consumption occurring in Alberta. However, if emphasis is placed on the costly benefits from education, infrastructure, and health care that are more likely to be funded by British Columbia, perhaps the result is appropriate.

14 Charles E. McLure Jr., "Topics in the Theory of Revenue Assignment: Gaps, Traps, and Nuances," in Mario I. Blejer and Teresa Ter-Minassian, eds., *Macroeconomic Dimensions of Public Finance: Essays in Honour of Vito Tanzi* (London: Routledge, 1997), 90-105, at 97.

15 Evelyn L. Forget, Leslie L. Roos, Raisa B. Deber, and Randy Walld, "Variations in Lifetime Healthcare Costs" (2008) 4:1 *Healthcare Policy* 148-67; and Canada, *National Health Expenditure Trends, 1975 to 2011* (Ottawa: Canadian Institute for Health Information, 2011), at 41-49.

The all-or-nothing outcome of residence-based taxation of employment and property income favours a shift toward consumption taxes by labour-importing provinces like Alberta. This would permit the labour-importing provinces to raise revenue commensurate with the benefits they provide.¹⁶ A shift to value-added taxes would also increase the relative efficiency of the provincial tax system, since the distortions caused by the decreased return on investment or labour resulting from the imposition of provincial income taxes would then be reduced.

The all-or-nothing outcome also favours a shift toward source-based provincial income taxation, in addition to other persuasive arguments in support of source-based taxation in the 21st century.¹⁷ While such a shift may result in increased opportunities for harmful tax competition, it would have the effect of eliminating the tax benefits of interprovincial planning involving the use of trusts, as discussed below.

Policy Considerations—Trusts

Conceptualizing the Trust and Alternatives for Taxation

Notwithstanding that subsection 104(2) of the Act deems a trust to be an individual in respect of the property of the trust, individuals are not necessarily a good tax policy analogy for personal trusts. The practical purpose of subsection 104(2) is to cause personal trusts to be taxed at individual income tax rates; as a legal abstraction, from a tax policy perspective a personal trust has more in common with investment vehicles such as corporations and partnerships than with individuals.

Robert Couzin has stated that the English common law conceptualizes a corporation as a “fiction or abstraction with a purely metaphysical existence.”¹⁸ This characterization can also be applied to a trust. Unlike an individual, but like a corporation, a trust is not a physical being, and depends on its constating documents, the laws of equity, and provincial statutes for its metaphysical existence. However, in contrast to a corporation, a trust is not a legal person with its own rights, but is instead an equitable or contractual relationship between the settlor, the beneficiaries, and the trustees, pursuant to which the trustees exercise rights on behalf of the beneficiaries.¹⁹

16 I acknowledge that, to the extent that the incidence of Alberta’s corporate income tax falls on labour, Alberta may in fact be taxing the non-resident individual. See Ken McKenzie and Charles Taylor, “Business Income Taxation,” in Heather Kerr, Ken McKenzie, and Jack Mintz, eds., *Tax Policy in Canada* (Toronto: Canadian Tax Foundation, 2012), 7:1-51, at 7:46-49.

17 See Jinyan Li, “Rethinking Canada’s Source Rules in the Age of Electronic Commerce: Part 2” (1999) 47:6 *Canadian Tax Journal* 1411-78. For arguments against increased source taxation, see Robert A. Green, “The Future of Source-Based Taxation of Multinational Enterprises” (1993) 79:18 *Cornell Law Review* 18-86.

18 Robert Couzin, *Corporate Residence and International Taxation* (Amsterdam: International Bureau of Fiscal Documentation, 2002), at 13.

19 The status of a trust as a non-entity may explain why it is necessary to resort to the relatively complex deeming of a trust to be an individual in respect of its property in subsection 104(2), instead of simply deeming a trust to be a “person” within the meaning of the definition in

Since a personal trust is not a legal entity, reasonable arguments could be raised against imposing income tax on the personal trust as an entity.²⁰ Tax could instead be imposed on the beneficiaries of the trust to the extent of their vested interests or on the basis of interests in the trust created by deeming rules, with income being computed as if the trust were an entity. This is similar to the manner in which tax is imposed on non-resident trusts under subsection 94(3),²¹ and is also similar to the manner in which partners and partnerships (another breed of quasi-entity) are taxed under subsection 96(1).

While theoretically justifiable, the current taxation of trust beneficiaries could be problematic as a result of the unique features of a trust. In contrast to most partnerships, the distribution of trust income and the amount of trust income to be distributed to a particular beneficiary are frequently left to the discretion of the trustee. It could be difficult to determine which beneficiaries should be taxed in respect of the income of the trust, and to what extent each should be taxed, since it is entirely possible that the beneficiaries selected may never benefit from the income of the trust, or may benefit to different degrees. In addition, since distributions may not be compellable, it is possible that the tax would be imposed on beneficiaries who would not have the ability to pay the tax at the time it was imposed, and a refund mechanism would have to be adopted for beneficiaries who paid income tax on income that was ultimately not received.

In the context of subsection 94(3), the issue of who benefits from the trust income and who is able to pay the income tax imposed on the non-resident trust is solved by making the Canadian-resident settlor and the beneficiaries jointly and severally liable for the Canadian income tax payable pursuant to paragraph 94(3)(d), subject to a recovery limit.²² This is an imperfect solution to the problem of assigning tax liability as between the beneficiaries and the settlor in the context of a regime that intends to tax beneficiaries currently, since the inclusion of a recovery limit could effectively prevent the collection of tax until such time as distributions are made, while the lack of a recovery limit could effectively cause the tax burden to be borne by the most solvent settlor or beneficiary of the trust, regardless of the benefits actually received.

subsection 248(1). Note, however, that the courts appear to have determined that since the effect of subsection 104(2) is to deem the trust to be an individual, “the fact that at common law a trust does not have an independent legal existence is irrelevant for the purposes of the Act”: *Garron*, *infra* note 55 (SCC), at paragraph 10.

20 A discussion of the policy rationale for the imposition of entity-level income tax on unit trusts and the basis of taxation for unit trusts is beyond the scope of this article. In my view, since a unit trust is a business vehicle that serves as a near-perfect substitute for a corporation, the neutrality principle dictates that a unit trust should be subject to the same entity-level tax as a corporation.

21 References to section 94 are references to the current version, which came into effect (in many instances, retroactively) when the Technical Tax Amendments Act, 2012, SC 2013, c. 34, received royal assent on June 26, 2013.

22 See subsections 94(7) and (8).

Insofar as a trust is a quasi-entity, the rationale for imposing an entity-level provincial income tax on corporations could also apply to a personal trust, and an integration regime similar to the corporate income tax could be adopted. Since, like corporate profits, distributions of trust income may not be predetermined or compellable, the imposition of entity-level tax as a form of withholding against the personal income tax liability arising on distribution can be justified.²³ This entity-level tax would eliminate the need to identify the beneficiaries who will ultimately receive the economic benefit of the trust income; the beneficiaries receiving a distribution would be taxed at a lower rate that would reflect their share of the entity-level tax paid by the trust.

The Current System and Residence Taxation

Canada and all of the provinces have adopted a hybrid between the two approaches to taxing trust income described above. As a deemed individual pursuant to subsection 104(2), a personal trust is subject to entity-level tax on its income at the highest marginal rate for individuals,²⁴ but is entitled to deduct from its income all amounts paid or payable to its beneficiaries.²⁵ The beneficiaries are not taxed on any distributions from a personal trust in respect of which tax was paid by the trust;²⁶ where the trust makes a distribution to a beneficiary in respect of which tax was not paid, a corresponding amount is included in the beneficiary's income,²⁷ and the character of certain items of income is preserved.²⁸

The adoption of the hybrid entity system of taxation necessitates the selection of a basis for imposing an entity-level tax on a personal trust. As a result of deeming a trust to be an individual, residence became the basis for imposing federal income tax on worldwide income of the trust. Since, as discussed above, each province has adopted a residence-based system for taxing the non-business income of individuals, provincial income tax on the worldwide non-business income of a personal trust is imposed in the province in which the trust is resident. A similar result would follow if the personal trust were taxed as a corporation.

23 McKenzie and Taylor, *supra* note 16, at 7:7-16. See also H. Heward Stikeman and Robert Couzin, "Surplus Stripping" (1995) 43:5 *Canadian Tax Journal* 1844-60.

24 Subsection 122(1). Testamentary trusts are excluded from the application of subsection 122(1) and are taxed at the marginal rates specified in section 117.

25 Paragraph 104(6)(b). Subsection 104(24) provides that an amount is payable to a beneficiary when it is paid or when the beneficiary is legally entitled in the year to enforce payment.

26 Note that, notwithstanding the potential for a deduction pursuant to paragraph 104(6)(b), a personal trust may elect to have its distributed income taxed in the trust and distributed tax-free pursuant to subsection 104(13.1). The ability to make this election is often an important feature of interprovincial tax planning using personal trusts, since it ensures that the trust's income can be taxed in the low-rate jurisdiction even if all of the income of the trust is distributed.

27 Subsection 104(13).

28 Subsections 104(19) through (22.4). Any other amount included in income pursuant to subsection 104(13) will be treated as income from property pursuant to subsection 108(5).

However, the rationale for selecting the place of residence of the personal trust as the basis for imposing provincial income tax appears substantially weaker than the rationale for imposing residence-based income taxes on an individual or a corporation. A personal trust is not a human being, and therefore does not receive most of the benefits of the public goods provided by any province; unlike a corporation, a personal trust is unlikely to carry on business, and is therefore unlikely to receive public goods from any particular province on behalf of its beneficiaries. With the possible exception of access to the judicial system, substantially all of the public goods that could be connected with a personal trust are provided by the province in which the beneficiaries of the personal trust are resident, and not the province in which the trust is resident (if those provinces are different).

The Downside of Residence Taxation and Reconsidering Alternatives

Since a personal trust does not have a physical existence and is unlikely to carry on any business, imposing provincial income tax on the basis of the residence of the trust separate from the residence of the beneficiaries invites taxpayers to elect the province in which they will pay tax. An individual who wishes to become a resident of a different province for income tax purposes will, at the very least, have to establish a home in that other province and spend considerable time there, while giving up the ability to live in the first province year-round. A corporation carrying on business in a province will typically do so through a permanent establishment, so the ability to relocate to avoid tax will be either limited or commercially impractical. In contrast, whether the test for trust residence is central management and control, the place of residence of the trustees, or the governing law chosen, the residence of a personal trust can be changed by holding the trustee meetings in the preferred jurisdiction, or simply by changing the trustees or the governing law.

The potential lack of connection between the provision of public goods and the residence of a personal trust could also encourage harmful tax competition between the provinces. Given the evidence that highly mobile income is particularly susceptible to being shifted between provinces to avoid provincial income taxes,²⁹ it is reasonable to expect that residence-based provincial income taxation for a quasi-entity with no physical presence, combined with an easily manipulated test for residence, would lead to the migration of personal trusts to lower-tax provinces. Given the negligible cost of public goods that must be provided to earn this income, there is a significant advantage for the province that imposes the lowest rate of tax on trust income, so interprovincial competition for personal trust tax residence should be expected.³⁰

29 Jack Mintz and Michael Smart, "Income Shifting, Investment, and Tax Competition: Theory and Evidence from Provincial Taxation in Canada" (2004) 88:6 *Journal of Public Economics* 1149-68.

30 Indeed, interprovincial tax competition is a key part of the so-called Alberta advantage and is recognized by the government of Alberta as a driver of economic growth: Philip Bazel and Jack M. Mintz, "Enhancing the Alberta Tax Advantage with a Harmonized Sales Tax" (2013) 6:29 *SPP Research Papers* 1-37, at 1.

The relative mobility of trust residence, and therefore the relative mobility of trust income, and the lack of connection between that income and the public goods provided, also argues for ceding the taxation of personal trusts to the federal government. This would have the effect of limiting tax competition, but it appears unlikely that the magnitude of the interprovincial income-shifting problem is sufficient to justify such a significant change to the division of taxing powers, or to justify a fundamental change in the test used to determine the provincial residence of personal trusts.³¹

Since the public good benefits associated with a personal trust and its income will typically be enjoyed in the province where the settlor or the beneficiaries are resident, and since the settlor and the beneficiaries will typically be resident in one province, a more reasonable residence-based approach to taxing personal trusts might be to deem a personal trust to be resident in the province where either the settlor or the beneficiaries are resident. Having regard for the relatively greater likelihood that there will be beneficiaries in multiple provinces, and for the reality that out-of-province discretionary beneficiaries could be added to manipulate any counting test, the residence of the settlor as a test may be a possible alternative.³² Where there are settlors in multiple provinces, the trust could be deemed to be separate trusts, with each trust being resident in the province of residence of the respective settlor(s) and holding property proportionate to the fair market value of the property contributed by the settlors(s).

A test of residence based on the residence of the settlor or the beneficiaries of the trust would not invite the same degree of manipulation as a central management and control test, a trustee residence test, or a governing-law test. The beneficiaries and the settlor of a trust would have significant non-tax reasons to avoid moving between jurisdictions in order to cause the trust to become resident in a lower-tax jurisdiction, and the residence of the trust could not be changed after the settlement of the trust. Limiting the mobility of trust income in this manner should also limit the potential for tax competition between provinces.

That said, the use of a settlor- or beneficiary-driven test for residence is not without its own flaws. For example, a settlor-based test could be frustrated using an arrangement similar to the one in *Sommerer v. The Queen*,³³ where a settlor in the desired jurisdiction settles the trust with a relatively insignificant amount of cash

31 The total tax revenue shifted out of other provinces through Alberta-resident personal trusts, for example, has been estimated to be in the range of “tens of millions of dollars”: Matt McClure, “Alberta Could Owe ‘Tens of Millions’ in Tax Dispute Over Out-of-Province Trust,” *Calgary Herald*, May 24, 2013.

32 Similar to the rules in section 94, the settlor for the purposes of this residence test would be the person who has borne the economic cost of transferring property to the trust, directly or indirectly, or through a series of transactions with the primary purpose of causing property to be received by the trust. This would not necessarily be the person who has completed the legal formality of settling the trust.

33 2011 TCC 212; aff’d. 2012 FCA 207.

and the trust then purchases the desired property at fair market value in exchange for interest-bearing debt. A settlor-based test would also require rules addressing indirect contributions and contributions by way of series of transactions, similar to the rules in section 94, significantly increasing administrative complexity. Furthermore, contribution of property by different persons at different times, and the resulting separate trusts, could result in situations where compliance and audit become extremely difficult.

While the adoption of a settlor-driven or beneficiary-driven test for trust residence could result in greater harmony between the delivery of public goods and the taxation of trust income, such a test would represent a significant departure from the current entity-based residence test. Moreover, the shift from an entity-based residence test to a settlor-driven or beneficiary-driven test for trust residence would likely require all of the provinces and the federal Department of Finance to act in concert, creating coordination problems. Given the relative simplicity of the entity-based residence test (whether determined by reference to the residence of the trustees or the place of central management and control) and the resulting all-or-nothing taxation of trust income in a single province, and given the relatively insignificant revenue loss for the higher-tax provinces, the cost of achieving greater harmony may well exceed its benefits. Such a fundamental change is therefore unlikely, and arguably unnecessary.

Although, given the difficulties associated with changing the laws for trust residence, such a change may not be justifiable from a bottom-line perspective, there is arguably a distributional aspect to the use of inter vivos trusts that is separate from the issue of potential revenue loss. Since substantially all of the individuals who engage in interprovincial trust planning are high net worth, high income earners, one effect of this planning is to shift the burden of provincial personal income taxes in high-tax provinces to wage earners and other less mobile individuals. For this reason, it is unsurprising that the Canada Revenue Agency (CRA) has seized the opportunity created by the adoption of the central management and control test for trust residence in an attempt to achieve the same results as might be delivered by a more robust settlor-driven residence test.

RESIDENCE OF TRUSTS

Statutory Provisions

Similar to subsection 104(1) of the Act, a trust is treated as an individual under provincial income tax legislation. For example, the Alberta Personal Income Tax Act³⁴ defines an “individual” as including a trust or estate, meaning that a trust will be subject to Alberta personal income tax if it is resident in Alberta on the last day of the taxation year.³⁵ Equivalent definitions and rules are found in the income tax

34 Alberta Personal Income Tax Act, RSA 2000, c. A-30, as amended (herein referred to as “APITA”).

35 APITA section 3(1).

statutes of the other nine provinces.³⁶ As an individual, a trust has a taxation year-end of December 31, unless the trust is an testamentary trust or an estate, in which case it will have the taxation year determined under the applicable statute.³⁷

Like the Act, the provincial taxation statutes provide that inter vivos trusts resident in the province will pay tax at the highest marginal rate; and, notwithstanding that inter vivos trusts are individuals for tax purposes, they are precluded from claiming personal tax credits other than charitable donation credits.³⁸ Some provinces, including Ontario and British Columbia, charge health-care premiums to individuals resident in those provinces, which may be collected through the provincial income tax system; these premiums do not apply to trusts.³⁹

None of the provincial taxation statutes or regulations prescribe a method for determining where a trust is resident on the last day of a taxation year. As a result, it is necessary to refer to the jurisprudence in order to determine in which province a trust will be resident for provincial income tax purposes, or if the trust is resident in a province at all.

Jurisprudence

Pre-Garron

Prior to 2009, the leading Canadian decision relating to the residence of trusts was the decision of the Federal Court Trial Division in *Thibodeau Family Trust v. The Queen*.⁴⁰ In that case, Gibson J considered the residence of an inter vivos trust, the majority of the trustees of which were resident in Bermuda. The trustees were able

36 See sections 1(1) and 2(1) of British Columbia's Income Tax Act, RSBC 1996, c. 215, as amended (herein referred to as "BCITA"); sections 2(q) and 6(1) of Saskatchewan's Income Tax Act, 2000, SS 2000, c. I-2.01, as amended (herein referred to as "SKITA"); sections 1(1) and 3(1) of Manitoba's Income Tax Act, CCSM, c. I10 (herein referred to as "MITA"); sections 1(1) and 2 of Ontario's Income Tax Act, RSO 1990, c. I.2, as amended (herein referred to as "OITA"); sections 1 and 22 of Quebec's Taxation Act, CQLR, c. I-3 (herein referred to as "QTA"); sections 1 and 11 of the New Brunswick Income Tax Act, SNB 2000, c. N-6.001, as amended (herein referred to as "NBITA"); sections 2(7) and 5 of Nova Scotia's Income Tax Act, RSNS 1989, c. 217, as amended (herein referred to as "NSITA"); sections 1(6) and 3 of Prince Edward Island's Income Tax Act, RSPEI 1988 c. I-1, as amended (herein referred to as "PEIITA"); and sections 2(1)(i) and 6(1) of Newfoundland and Labrador's Income Tax Act, 2000, SNL 2000, c. I-1.1, as amended (herein referred to as "NLITA").

37 See paragraph 249(1)(c) and subsection 249(5) of the Act and the definition of "taxation year" in BCITA section 1(1), APITA section 1(1)(w), SKITA section 2(bb), MITA section 1(1), OITA section 1(1), QTA section 1, NBITA section 1, NSITA section 2(1)(r), PEIITA section 1(1)(q), and NLITA section 2(1)(s).

38 See subsections 122(1) and (1.1) of the Act; BCITA sections 4.1(3) and 4.73; APITA section 36; SKITA sections 9(1) and 41; MITA sections 4(1), rule 1(a), and 4.1(3); OITA sections 4(3)(4) and 4(3.2)(11); QTA sections 750.1.1, 768, 770, and 770.1; NBITA sections 42 and 43; NSITA section 28; PEIITA section 27; and NLITA section 27.

39 See Medicare Protection Act, RSBC 1996, c. 286, as amended, OITA section 2.2(3), and the definition of "beneficiary" in section 1 and the charging provision in section 8.

40 78 DTC 6376 (FCTD).

to adduce evidence that all decisions relating to the property of the trust were made at meetings held in Bermuda, and that, although a trustee-beneficiary resident in Canada had the right to suggest investments, the Bermuda trustees had the right to overrule his recommendations and, on occasion, did so.⁴¹

The minister advanced a number of arguments in support of his position that the trust was resident in Canada. First, the minister argued that the central management and control test for corporate residence in *De Beers Consolidated Mines, Limited v. Howe*⁴² should apply for this purpose. Second, the minister argued that the trust could be resident in both Canada and Bermuda, and the facts provided sufficient basis for the imposition of Canadian tax.⁴³ The following facts were cited as support for the minister's argument:⁴⁴

- One of the trustees was resident in Canada.
- The trustee resident in Canada had the power to appoint the other trustees.
- The Canadian-resident trustee was the principal initiator of the trust's investment program.
- The authority of the Bermuda trustees was circumscribed in respect of certain accounts.
- The Canadian-resident trustee was the chief executive officer of a Canadian corporation that paid the expenses of the trust.
- The Canadian-resident trustee was responsible for the negotiation of the sale of the trust's most important assets.
- The Canadian-resident trustee would, on occasion, take actions without consulting the Bermuda trustees.

Third, the minister raised a number of issues relating to provincial law, alleging that the appointment or resignation of trustees was ineffective, that the governing laws were the laws of Ontario, that the governing laws were not complied with, that the trust was in fact settled by the Canadian-resident trustee, and that the property of the trust was not transferable in Bermuda. All of these arguments were quickly disposed of by Gibson J, whose most important holding on these points was that a variation of the trust was not necessary to effect a change in the place of administration of the trust.⁴⁵

41 Ibid., at paragraph 13. For a fuller discussion of the facts and analysis in *Thibodeau* and a comparison of those facts and analysis with the Tax Court of Canada decision in *Garron*, infra note 55, see Fauzia Ahmed, "Tax Residency of a Trust: The Need for a New Test? New Developments in the Residency of a Trust" (2010) 29 *Estates Trusts & Pensions Journal* 219-43.

42 [1906] AC 455, at 458 (HL).

43 This argument was premised on the decisions in *Union Corporation, Ltd. v. IRC*, [1952] 1 All ER 646 (CA), and *Unit Construction Co. Ltd. v. Bullock (Inspector of Taxes)*, [1960] AC 351 (HL).

44 *Thibodeau*, supra note 40, at paragraph 16.

45 Ibid., at paragraph 21.

Gibson J went on to address the minister's first and second arguments. In disposing of the minister's submission that the central management and control test should be used to determine the place of residence of a trust, Gibson J held as follows:

[I]n 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 [omission in original] 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.⁴⁶

It is reasonably clear from the comments of Gibson J that he was ruling that the central management and control test was not applicable on the basis that the trustees were not permitted to delegate their authority in the same manner as corporate directors. As a result, it was necessary to resolve the question of residence by some other means.

In deciding that the trust was resident in Bermuda, Gibson J explicitly stated that his formulation of the test for trust residence was to be employed only in the case before him. After considering various factors, Gibson J selected the place of residence of the majority of the trustees and the "majority rules" clause as being the determinative factors.⁴⁷ Applying these criteria to the facts, the trust was resident in Bermuda and not in Canada.

Although Gibson J's reasons for judgment do not discuss this point, the factors that he selected as being determinative of residence mirrored the rules that apply when determining, for non-tax purposes, the law that governs the administration of a trust. Under those rules, the place of residence of the trustees, while not conclusive, is of paramount importance in determining the law that governs whether a trust exists and the law that governs the administration of the trust.⁴⁸ Moreover, the decision in *Thibodeau* was consistent with at least one older decision relating to provincial succession duties, wherein it was held that succession duties could be levied by the province in which the trustee of a trust was resident, on the basis that

46 Ibid., at paragraph 22 (emphasis added).

47 Ibid., at paragraphs 23-25.

48 *Branco v. Veira* (1995), 8 ETR (2d) 49, at paragraphs 17-20 (Ont. Gen. Div.), citing *Nanton Estate, Re*, [1948] 2 WWR 113, at paragraphs 22-24 (Man. KB). See also *Re Jagos (Estate of)*, [2007] ABQB 56, at paragraph 45. However, see *Harris Investments Ltd. v. Smith*, [1948] 1 DLR 748, at paragraph 1 (BCCA), where the conflict-of-laws issue relating to a trust whose deed did not specify a governing law was resolved in favour of the place where substantially all of the acts dictated by the deed were required to be performed.

an interest in a trust constituted a claim against the trustee, and therefore a chose in action situated in the province.⁴⁹

As is evident from *Interpretation Bulletin* IT-447,⁵⁰ the minister never accepted the reasoning in *Thibodeau*. IT-447 states that, as a general proposition, a trust is resident in the place where the trustee who exercises the majority of the control of the property of the trust resides. Moreover, where a substantial portion of the management and control of the trust rests with a person who is not a trustee, the trust is resident where that person is resident. In effect, the minister continued to take the position that the central management and control test was determinative.

Interestingly, the minister did rely on *Thibodeau* in one subsequent case to establish that a trust, if it existed, was not resident in Canada.⁵¹ The minister also relied on *Thibodeau* in some technical interpretations,⁵² and a reference to the decision appeared in the CRA's internal instructional materials as authority relating to the residence of trusts.⁵³ In these instances, the minister's willingness to embrace *Thibodeau* seemed to depend on the outcome of reliance on that decision: if the result or potential result of relying on *Thibodeau* was more Canadian income tax payable, then the minister appeared likely to advance the residence of the trustees as a determinative test without hesitation.

The ratio in *Thibodeau* was not considered in any provincial income tax residence cases or by any provincial tax administration bodies. However, in *Beit c. Québec (Sous-ministre du Revenu)*, which dealt with the liability of trust beneficiaries for Quebec succession duty, Brossard JQC held that the principle from *Thibodeau* was generally accepted, and a trust should be resident in the place where the majority of its trustees were resident.⁵⁴

Notwithstanding the minister's, at best, lukewarm embrace of *Thibodeau*, and Gibson J's caveat that his formulation of the trust residence test was intended to be applied to that case alone, for the next 30 years many practitioners proceeded on the basis that the *Thibodeau* formulation was the law in Canada. The acceptance of this formulation by many practitioners, and its non-acceptance by the minister, set the stage for what was to come.

49 *Attorney General of Nova Scotia v. Davis*, [1937] 3 DLR 673 (NSSC). See also *Royal Trust Co. v. R*, [1949] SCR 329, at paragraphs 32-36, where a similar argument was raised, although the argument was unsuccessful once the court found that there had been a completed gift of the purported trust property.

50 *Interpretation Bulletin* IT-447, "Residence of Trust or Estate," May 30, 1980, at paragraphs 5-6.

51 *Low v. The Queen*, 93 DTC 927, at paragraph 44 (TCC).

52 CRA document nos. 5-8480, October 3, 1989; 9132105, February 21, 1992; and 2003-0006967, June 4, 2003.

53 Canada, *International Transactions—Tax Law Reference Manual* (Ottawa: Canada Revenue Agency, 1995), at 95 ITC 658.

54 1989 CarswellQue 441, at paragraphs 49-51; aff'd. [1994] RDFQ 39 (CA).

Garron

The assumption that the ratio in *Thibodeau* was the law of trust residence was shattered by the successive decisions of the Tax Court of Canada, the Federal Court of Appeal, and the Supreme Court of Canada in the *Garron* case.⁵⁵ In *Garron*, all three courts held that the correct test for the residence of a trust was the central management and control test favoured by the minister, and that the person with central management and control need not be a trustee.

The material facts in *Garron* were broadly similar to the facts in *Thibodeau*.⁵⁶ In *Garron*, the property of the purportedly non-resident trusts initially consisted of shares of private corporations, which were sold in transactions negotiated by a Canadian-resident beneficiary of one of the trusts, and either distributed to other trusts or replaced with a portfolio of securities. The sole trustee of the trusts was a corporation resident in Barbados that was licensed to provide trustee services. The trustee could be replaced at any time by a protector, who could himself be replaced by a majority of the beneficiaries who had attained a specified age. The evidence disclosed that the Canadian-resident beneficiaries were largely responsible for the investment decisions of the trusts, and that the trustee would simply ratify the decisions of the Canadian-resident beneficiaries and perform administrative tasks.

At trial, Woods J rejected *Thibodeau* on the basis that Gibson J had not intended his formulation to become a test for trust residence in other cases, and held “that there was nothing on the particular facts in *Thibodeau* that would support a finding that the trust was resident in Canada.”⁵⁷ Woods J further held that, in light of *Robson Leather Co. Ltd. v. MNR*,⁵⁸ Gibson J was not correct in holding that a trustee could be presumed to comply with its fiduciary obligations, or that a trustee could not delegate its authority, and that these determinations should be made on the basis of the facts of each case.⁵⁹

Since there are many significant factual similarities between *Thibodeau* and *Garron*, including Canadian residents who negotiated the sale of significant assets and initiated investment decisions, it is difficult to accept Woods J’s characterization of the *Thibodeau* facts. However, it was undoubtedly reasonable for Woods J to conclude that trustees should not be assumed to comply with their fiduciary obligations where the facts suggest otherwise, since the assumption of compliance would lead courts to ignore blatant abdications of office by trustees.

55 2012 SCC 14 (sub nom. *Fundy Settlement v. Canada*); aff’g, 2010 FCA 309 (sub nom. *St. Michael Trust Corp. v. Canada*); aff’g, 2009 TCC 450 (sub nom. *Garron Family Trust v. The Queen*).

56 Full details of the facts in *Garron* can be found in the decision of the Federal Court of Appeal, supra note 55, at paragraphs 15-49.

57 *Garron*, supra note 55 (TCC), at paragraph 138.

58 77 DTC 5106 (FCA).

59 *Garron*, supra note 55 (TCC), at paragraphs 145-150.

After concluding that the *Thibodeau* formulation was inapplicable, Woods J adopted the *De Beers* central management and control test as the appropriate test for trust residence, for two reasons: (1) the function of both trusts and corporations is the management of property; and (2) adopting the same test for corporations and trusts achieves consistency, predictability, and fairness. According to Woods J, Parliament left the test for trust residence to the courts, and the courts should not develop a different test than the one that they have adopted for corporations without good reasons for doing so.⁶⁰

At the Federal Court of Appeal, Sharlow JA noted that many commentators had believed that *Thibodeau* established a test for the residence of trusts, but held that Woods J was correct that this was not the case, and that the correct test is central management and control.⁶¹ In her view, it was not appropriate to adopt a rigid test, such as the place of residence of the trustees, and residence should instead be determined on the basis of a fact-driven inquiry as to where the trust “keeps house and does business.”⁶² Ordinarily, central management and control would be located where the trustees are resident, but this must be determined on a case-by-case basis.

Sharlow JA also considered two new arguments raised by the taxpayers. First, the taxpayers argued that the trust could not itself be resident anywhere, since it lacks legal personality, so reference must be made to the residence of the trustee. The second, related argument was that subsection 104(1) embodies the trust in the trustee.⁶³ Sharlow JA disposed of these arguments by noting that the Act treats the trust as though it were a person, thus creating an implicit statutory fiction that the trust need not be resident where the trustee is resident. Further, the reference in subsection 104(1) to the trustees exists for administrative convenience, and does not necessarily signal that Parliament intended that a trust be resident where its trustee is resident.

The decision of the Supreme Court of Canada in *Garron* is rather unsatisfying, since it adds little to the decision of the Federal Court of Appeal. The brief, 19-paragraph decision belies the importance of this issue to many Canadian taxpayers, and does not reflect the skilful argument before the court or the thorough reasons given by Woods J and Sharlow JA. Interestingly, the decision in *Garron* appears to be only the second income tax decision issued by the Supreme Court since 1980 without attribution to a particular justice,⁶⁴ a practice typically reserved for more contentious issues,⁶⁵ and the first such decision in which the Supreme Court has given its own reasons for allowing or dismissing an appeal.

60 *Ibid.*, at paragraphs 158-162.

61 *Garron*, *supra* note 55 (FCA), at paragraphs 57-62.

62 *Ibid.*, at paragraph 62 (quoting from *De Beers*, *supra* note 42, at 458).

63 *Ibid.*, at paragraphs 63-64.

64 The other such decision being the very brief reasons in *Del Zotto v. Canada*, [1999] 1 SCR 3.

65 See, for example, *Reference re Succession of Quebec*, [1998] 2 SCR 217.

The Supreme Court began its analysis by suggesting that there was “a dearth of judicial authority” relating to the residence of trusts⁶⁶—a questionable statement in light of the decision in *Thibodeau*, which the court declined to address. The court disagreed with the taxpayers’ submissions relating to the non-entity status of trusts and the reference to trustees in subsection 104(1), for substantially the same reasons as those expressed by Sharlow JA, although the court did note the importance of subsection 104(2), which separates a trust and its trustees for the purposes of the charging provision in subsection 2(1).⁶⁷

Agreeing with Woods J that the function of both corporations and trusts is the management of property, the court held that the central management and control test was appropriate, and that this would promote “consistency, predictability and fairness.”⁶⁸ Like Woods J, the court was not able to identify any good reason why there should be totally different tests of residence for corporations and trusts.

It is questionable whether the adoption of the central management and control test enhances “consistency, predictability and fairness,” although the application of the test to trusts certainly enhances fairness from a neutrality standpoint, given the observed similarities between corporations and trusts. In essence, a quantitative analysis of the place of residence of the trustees was supplanted by a much more qualitative or subjective analysis of where the mind and management of a trust is exercised. Correctly or incorrectly, for over 30 years, many Canadians and their tax advisers had been operating on the assumption that the *Thibodeau* formulation was the test for trust residence. The sudden adoption of the central management and control test represents a game changer and was certainly not predictable. Arguably, given the widespread acceptance of the *Thibodeau* formulation, such a game changer should have been left to Parliament.⁶⁹

Although *Garron* was decided in the context of determining the residence of a trust for the purposes of the federal Act, there is no compelling reason why *Garron* would not apply in the context of interprovincial residence. As a result, whether a trust is resident in a particular province in a taxation year will depend on whether the central management and control of the trust is located in that province on the last day of that taxation year.

66 *Garron*, supra note 55 (SCC), at paragraph 8.

67 *Ibid.*, at paragraphs 10-13.

68 *Ibid.*, at paragraphs 14 and 16 (quoting Woods J at the Tax Court of Canada, supra note 55, at paragraph 160).

69 See, for example, *Vancouver Society of Immigrant and Visible Minority Women v. MNR*, [1999] 1 SCR 10, where a majority of the Supreme Court of Canada, per Iacobucci J, declined to substantially revise entrenched common-law definitions of charitable purposes, on the basis that such changes were within the domain of Parliament.

Central Management and Control

If central management and control is the test for determining the residence of trusts, it is necessary to understand what “central management and control” means. The Supreme Court simply restated the *De Beers* standard of “keeping house and doing business,” and explained that, in the corporate context, central management and control would be exercised in the place where the powers of the board of directors of the corporation are exercised.⁷⁰

It is apparent that central management and control is a question of fact to be resolved in each case, and there is no formula that will establish that central management and control is located in a particular place. This was made clear by Sharlow JA, who noted that the use of a protector, the use of the same professional advisers, and the making of strong recommendations by the beneficiaries as to the management of property would not, in and of themselves, cause central management and control to be situated with persons other than the trustee.⁷¹ However, where the decisions that would typically constitute control over the property of the trust were dictated to the trustees, central management and control would be situated with the persons dictating those decisions.⁷²

As indicated by the courts in *Garron*, the threshold for a decision that is “dictated” to a trustee is high. However, following the recent decision of the English Court of Appeal in *Revenue and Customs Commissioners v. Smallwood*,⁷³ it would be open to a trial judge to find that the central management and control of a trust resides elsewhere than with the trustee in circumstances where the trustee is appointed as part of a preordained scheme originated by some other person, and the trustee does not, in fact, do anything except carry out the preordained transactions.⁷⁴ In such cases, the person orchestrating the scheme can be found to have central management and control of the trust.

Sharlow JA provided the following additional guidance with respect to the meaning of “central management and control” in the trust context:

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

70 *Garron*, supra note 55 (SCC), at paragraphs 8-9.

71 *Garron*, supra note 55 (FCA), at paragraphs 67-68.

72 *Garron*, supra note 55 (TCC), at paragraphs 177-180, citing *Wood v. Holden*, [2006] EWCA Civ. 26, at paragraphs 40-41.

73 [2010] EWCA Civ. 778; rev'g. [2009] EWHC 777 (Ch.). This decision relates to the “place of effective management” under the bilateral tax treaty between the United Kingdom and Mauritius. However, the jurisprudence relied on by the Court of Appeal to determine the meaning of “place of effective management” is the same as the jurisprudence relied on to determine “central management and control,” so there should not be any practical difference between these terms.

74 *Smallwood*, supra note 73 (CA), at paragraph 70.

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.⁷⁵

It appears that Sharlow JA was of the view that the location of central management and control of a trust is determined by identifying the person exercising management and control over the *property* of the trust, and the place where this control is exercised. This makes sense given that the reason for the existence of trusts is the holding of property for others and that, in most cases, the trust will be a passive owner of property and will not carry on an active business that requires day-to-day management.

This interpretation of the central management and control test accords with what appear to have been the most critical facts in issue in *Garron*. In particular, persons other than the trustee were able to direct dispositions of the property of the trusts, to choose the investments made by the trusts, to cause the trusts to make distributions, and to determine what tax planning the trusts would engage in, notwithstanding that these rights were reserved to the trustee. These powers are essentially property rights.

What, then, is required for a person to have “control” over the property of a trust? Control over property was recently considered by the courts in the context of beneficial ownership in *Prévost Car Inc. v. The Queen*⁷⁶ and *Velcro Canada Inc. v. The Queen*.⁷⁷ In those cases, the courts identified four incidents of beneficial ownership of property: possession, use, risk, and control.⁷⁸ With respect to the determination of central management and control, possession and use of the trust property and the incurring of risks associated with the trust property are generally not in issue, whereas control of the trust property is of paramount importance.

In *Velcro*, Rossiter ACJ adopted a definition of “control” that reads, “to exercise power or influence over” property, and gave meaning to the phrase “power or influence” by reference to the indicia of possession, use, and risk.⁷⁹ Of the various indicia of control identified by Rossiter ACJ in the context of monies received as

75 *Garron*, supra note 55 (FCA), at paragraph 62 (emphasis added).

76 2008 TCC 231; aff’d. 2009 FCA 57.

77 2012 TCC 57.

78 *Ibid.*, at paragraph 29.

79 *Ibid.*, at paragraphs 41-42.

royalty payments, some should be relevant in determining “control” of trust property, such as securities, real property, or other investments. These indicia include the following:

- The right to receive any income from the property held by the trust, and the right to put the income from the property to any desired use.⁸⁰
- The right to exercise “dominion” over the property.⁸¹ Dominion could include the right to vote shares, the right to enforce payment of debts, and the right to freely dispose of the property held by the trust.
- The right to “employ” the trust property.⁸² Trust property could be employed either by pledging it as security for borrowing by the trust, by holding it for capital appreciation or income generation, or by otherwise using the property in whatever manner it can be used.
- The right to incur risk of economic losses.⁸³ In the case of a trust, the risk of economic loss is always borne by the beneficiaries, and the property of the trust should not be available to creditors of any person other than the trust or a beneficiary with a fixed interest. However, a person with control over property may have a right to determine how the risks associated with the trust property are to be mitigated, or if those risks are to be mitigated at all.

Combined with the directions of Sharlow JA in *Garron*, these indicia of control over property can be used to gain some insight into what the central management and control of a trust should entail. If, as a matter of fact, the trustee exercises the rights that constitute control over the property of the trust, then the trustee should be the person having central management and control of the trust. In contrast, if some person other than the trustee exercises control over the property of the trust, or dictates to the trustee how the rights constituting control should be exercised, then that other person should have central management and control of the trust.

Once the identity of the person who has central management and control is ascertained, the residence of the trust can be resolved by identifying the place where that person exercises the powers constituting central management and control. Typically, this would be the place in which the person exercising these powers is resident, but that will not necessarily be the case. In a situation where very little management or control of trust property is required (as might be the case if substantially all of the assets of the trust consist of preferred shares of a private corporation), it might be possible for the person who has central management and control to ensure that central management and control is exercised in a province or country other than the

80 Ibid., at paragraph 35.

81 Ibid.

82 Ibid., at paragraph 36.

83 Ibid., at paragraph 39.

province or country in which that person resides.⁸⁴ One must caution, however, that this will require the decision making in connection with the trust property to be taken in a more formal manner than might otherwise be the case.

An argument could be made that the comments of the courts in *Garron* that the determination of central management and control is factually driven, and that there is a “line to be drawn,”⁸⁵ combined with the comments of the courts that the central management and control test for trusts is “similar” to the central management and control test for corporations,⁸⁶ means that the central management and control test is to be applied as a de facto control test. In this interpretation of the decisions in *Garron*, the actual act of making decisions and the place where those decisions are made is disregarded, while paramount importance is placed on the ordinary location of the persons who effectively control the decision making for the trust.

I strongly disagree with this argument for a number of reasons, set out below, and I believe that this interpretation of the central management and control test is an attempt to replace what was said in *Garron* with what those advancing the argument would have preferred to read.

- The attempt to read meaning into the use of the phrase “similar” ignores the fact that the central management and control test for trusts cannot be the “same” as the central management and control test for corporations as articulated in *De Beers*, since a trust does not have a board of directors. This is why the Federal Court of Appeal adopted the central management and control test by analogy to *De Beers*.⁸⁷
- The above interpretation of the word “similar” ignores the context in which it appears. When Woods J held that “[i]t is desirable that the test for corporations and trusts be as similar as the circumstances allow,”⁸⁸ after discussing the similar functions of corporations and trusts and the need for consistency, predictability, and fairness, the reasonable interpretation is that Woods J was concerned with neutrality, not with creating latitude for the courts to rely on de facto control in determining residence.

84 For this reason, the central management and control test should not be effective as an anti-avoidance rule. It should be relatively simple for a properly informed and diligent taxpayer to locate central management and control in a desirable jurisdiction, particularly where little management of property is required. Indeed, Arnold, *supra* note 4, argues that the central management and control test for corporate residence should be repealed on the basis that it is too prone to ongoing manipulation. For further thoughts on how central management and control may be located in a desired jurisdiction, see Howard Carr, “Residence of a Trust: *Fundy Settlement v. Canada*” (2012) 18:9 *Trusts & Trustees* 907-10.

85 *Garron*, *supra* note 55 (FCA), at paragraphs 67-68.

86 *Garron*, *supra* note 55 (SCC), at paragraph 16, and (TCC), at paragraphs 159-160 and 170.

87 *Garron*, *supra* note 55 (FCA), at paragraph 62.

88 *Garron*, *supra* note 55 (TCC), at paragraph 170.

- As evidenced by the decision of the Court of Appeal in *Wood v. Holden*,⁸⁹ the central management and control test for corporations is a formalistic test; provided that decisions were not dictated, central management and control was located where the directors were when they made the relevant decisions by signing the relevant resolutions. In *De Beers*, the critical fact was that all significant decisions were made at meetings of the directors in London; no inquiry was made as to whether the decisions made at those meetings had been contemplated by the directors before arriving in London to formally make those decisions.⁹⁰ The jurisprudence since *De Beers* has developed such that paramount importance is accorded to the place where directors meet, and not the place where the directors (or even the sole director) are resident.⁹¹ The Canadian courts were undoubtedly aware of this formalism when they adopted the central management and control test.
- The use of a formalistic central management and control test for corporations and a de facto central management and control test for trusts would undermine the neutrality principle upon which the decisions in *Garron* are premised.
- The use of de facto control tests is not novel, and such tests can be found throughout the Act.⁹² If the courts intended trust residence to be based on the place of residence of the individual with de facto control, as opposed to the place where decisions are made, the courts would know how to articulate such a test.

For these reasons, in my view, once the elements of control in respect of the trust property have been ascertained, it is the place from which that control is exercised that is relevant, and not the day-to-day location of the “controller.” If it can be proved that control is exercised at a meeting in a particular jurisdiction, then, by analogy to a corporation and the making of decisions in the place where the board of directors meets, central management and control is situated in that particular jurisdiction. Again, this may require a more formal decision-making process than would typically be associated with a domestic personal trust, such that there is evidence of the place where decisions are made, but it does not require the person with control to remain in the desired jurisdiction of residence at all times.

To summarize, a trust will be resident in a province in a taxation year if, on the last day of that taxation year, central management and control of the trust is exercised in the province. For these purposes, central management and control should

89 *Wood v. Holden*, supra note 72, at paragraphs 40-41.

90 *De Beers*, supra note 42, at 459.

91 See Couzin, supra note 18, at 58-63, citing, inter alia, *John Hood & Company, Limited v. W.E. Magee (Surveyor of Taxes)* (1918), 7 TC 327, at 350 (Ire. KB).

92 See, for example, paragraph 40(2)(a); subsection 44(7); subsection 125(7), the definition of “Canadian-controlled private corporation”; subsection 251.1(3), the definition of “controlled”; and subsection 256(1).

be a reference to the control of the property of the trust, and central management and control should be exercised by the person who is determined to have control over the trust property. The question of provincial residence should be resolved by answering three questions of fact:

1. What bundle of rights constitutes control of the property owned by the trust?
2. Who is the person exercising or dictating the exercise of the rights that constitute control of the trust property?
3. From where does this person exercise those rights or dictate the exercise of those rights on the last day of the taxation year?

If the answer to question 3 is that the rights are exercised in the particular province on the last day of the taxation year, the trust is resident in that province in the year. If the answer to question 3 is that the rights are exercised outside the particular province on the last day of the taxation year, the trust is not resident in that province in the year.

The CRA's Audit Program and Dispute Resolution

It appears that, following the decision of the Tax Court of Canada in *Garron*, the CRA's aggressive tax planning audit groups have begun an audit program targeting Alberta-resident trusts with beneficiaries resident in other provinces.⁹³ The CRA's primary position is that the central management and control of these trusts is located in the provinces in which the beneficiaries are resident, and that the trusts should therefore be subject to tax at the higher non-Alberta rates. In some instances, the CRA is also alleging that the appointment of the Alberta trustee is a sham.⁹⁴

In most cases, the purpose of the Alberta trust is to hold non-voting common or preferred shares of a private corporation resident in another province. The corporation pays dividends on the common shares (or deemed dividends on the repurchase of the preferred shares) in order to receive a refund of refundable dividend tax on hand under subsection 129(1), and the trust pays tax on the resulting taxable dividend at Alberta rates. The Alberta trust may only receive sufficient cash to pay the tax payable on the dividends, along with a promissory note for the remaining amount payable, or may be paid in cash that is then used by the Alberta trust to acquire marketable securities or other income-producing property.

The CRA's audits of these Alberta trusts often focus on the central management and control or the day-to-day management of the private corporation in which the

93 For additional detail relating to the CRA's audit program, see Randy Bella and William Fowles, "The Final Word on Trust Residence? Thoughts on the Implications of the Garron Case," in *Report of Proceedings of the Sixty-Fourth Tax Conference*, 2012 Conference Report (Toronto: Canadian Tax Foundation, 2013), 37:1-25.

94 This is an attempt to achieve a result similar to the result in *Antle v. Canada*, 2010 FCA 280; aff'g. 2009 TCC 465.

Alberta trust owns shares, instead of identifying the person who controls the property of the Alberta trust. In many cases, this has resulted in reassessments being vacated by the CRA's Appeals Division, once the *Garron* analysis is properly focused on the trust and the trust property, as opposed to the private corporation in which the trust owns shares. While the CRA's approach to locating central management and control using the day-to-day operations of this subsidiary corporation achieves a result that is defensible from a policy perspective, for the reasons discussed above, its approach requires a jurisprudential evolution in order to be technically correct.

In addition to the focus on the management of the private corporation, the CRA's audits of Alberta trusts have been fixated on the tax-avoidance motivation underlying the creation of the Alberta trust. While the English Court of Appeal decision in *Smallwood* suggests that tax avoidance might be relevant in the case of a pre-ordained series of transactions where the trustees terminate their office as part of the series, the CRA is applying this reasoning to Alberta trusts that continue after the initial series of transactions, including those where the Alberta trusts acquire and hold investments into the indefinite future.

In my view, the CRA auditors are allowing the tax-avoidance motivation to colour their analysis, and the resulting incomplete or inadequate analysis has also resulted in the issuance of reassessments that have been vacated by the CRA's Appeals Division. Since the *Duke of Westminster* principle is still the law in Canada,⁹⁵ a tax-avoidance motivation should not be relevant in determining the tax consequences of an arrangement, absent the potential application of a specific anti-avoidance rule or the general anti-avoidance rule (GAAR).⁹⁶ This principle applies to the determination of trust residence, since the underlying facts that are relevant in locating control of trust property are not somehow altered by the motivation of the settlor or the beneficiaries of the trust.

As is the case with disputes relating to the residence of individuals, the proper forum for an appeal from a reassessment issued under a provincial taxation statute is the superior court of the province in which the CRA alleges that the trust is resident.⁹⁷ The Tax Court of Canada does not have the jurisdiction to hear such an appeal, since provincial taxation statutes are not listed in section 12 of the Tax Court of Canada Act.⁹⁸ In my experience, the CRA's letters accompanying its notices of confirmation

95 See, for example, *Coptborne Holdings Ltd. v. Canada*, 2011 SCC 63, at paragraph 65, citing *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1 (HL).

96 An interprovincial tax-avoidance motivation is relevant in applying GAAR only insofar as it relates to determining whether an avoidance transaction exists: *Husky Energy Inc. v. Alberta*, 2011 ABQB 268, at paragraphs 72-73; aff'd. 2012 ABCA 231, leave to appeal to the Supreme Court of Canada dismissed.

97 See, for example, the definition of "court" in BCITA section 1(1), APITA section 1(1)(g), SKITA section 2(i), and MITA section 1(1). Also see the appeal provisions in OITA section 23(1).

98 RSC 1985, c. T-2, as amended.

for provincial reassessments arising out of trust residence disputes often state that an appeal may be filed in the Tax Court of Canada, but that is not correct.

The challenge of identifying the proper forum for resolving trust residence disputes, particularly where trust residence is an alternative basis of assessment, is highlighted by the recent decision of the Court of Queen's Bench of Alberta in *Sheila Holmes Spousal Trust v. Canada (Attorney General)*.⁹⁹ *Holmes* involved an application by a trustee for a declaration that the trust was duly constituted and that the trust was not a sham. The determination of the validity of the trust and the validity of the trustee's appointment was potentially dispositive of the question whether the income and capital gains realized by the trust would be taxed in Alberta, where the would-be trustee was resident, or in Ontario, where the would-be settlor and beneficiaries were resident.

Nixon J dismissed the trustee's application for declaratory relief, on the basis that the Tax Court of Canada had the exclusive jurisdiction to determine the validity and residence of the trust (as it had done in *Antle*),¹⁰⁰ and that any interpretation of Alberta law required was within the competence of the Tax Court of Canada.¹⁰¹ This was clearly the correct conclusion on the facts presented in the decision, since the issue of the validity of the trust and the validity of the trustee's appointment were not merely ancillary to the minister's reassessment, but went to the very heart of the dispute. Granting declaratory relief would have usurped the fact-finding role of the trial judge who might eventually consider the correctness of the reassessment.¹⁰²

While Nixon J correctly declined to interfere with the jurisdiction of another court, her reasons for judgment are not as precise as they could have been in identifying the court to which this courtesy was owed. Nixon J cited *Garron* and *Antle* as examples of cases where the matters to be determined had been dealt with by the Tax Court of Canada, and where the Tax Court of Canada had made all necessary findings of fact to determine those matters.¹⁰³ Nevertheless, while the matters in issue in *Holmes* were similar to the matters in issue in *Garron* and *Antle*, the distinction between the latter two cases and *Holmes* is the statute under which the tax in dispute was assessed. In *Garron* and *Antle*, tax was assessed pursuant to the Act, and the questions of whether the trust was duly constituted (in *Antle*) and where the trust was resident (in *Garron*) arose in the context of determining whether federal income tax was payable. In *Holmes*, the settlor was to be assessed pursuant to both the federal

99 2013 ABQB 489.

100 *Antle*, supra note 94.

101 *Holmes*, supra note 99, at paragraphs 20-22 and 60-74.

102 For a more detailed summary of the facts and analysis in *Holmes*, including an argument that the decision of Nixon J is incorrect, see Allison Blackler and Joel Nitikman, "Case Comment," in *2013 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2013), 2:1-29.

103 *Holmes*, supra note 99, at paragraph 22.

Act and the equivalent Ontario statute (the OITA),¹⁰⁴ or, in the alternative, the trust was to be assessed under the OITA only, and the critical issue in either case was the jurisdiction in which provincial income tax was payable.¹⁰⁵

To the extent that the minister ultimately assesses the trust as the agent of the province of Ontario pursuant to the OITA, on the basis that the trust was resident in Ontario, the proper forum for the dispute between the trust and the minister will be the Ontario Superior Court of Justice pursuant to sections 23(1) and (2) of the OITA. The exclusive jurisdiction of the Superior Court of Justice to hear an appeal from such an assessment was noted by both Nixon J and the attorney general of Canada.¹⁰⁶ As stated above, the Tax Court of Canada does not have the jurisdiction to resolve a dispute arising under a statute that is not listed in section 12 of the Tax Court of Canada Act, and that list does not include the OITA.

To the extent that the minister ultimately assesses the settlor to include the income or capital gains purportedly realized by the trust in the settlor's income for the purposes of the Act, either because the trust was a sham or because subsection 75(2) applied, the Tax Court of Canada would be the proper forum to contest the reassessment. The proper forum for contesting any corresponding reassessment of the settlor under the OITA is the Superior Court of Justice, although the CRA will generally confirm, vary, or vacate reassessments under the provincial income tax statutes on the basis of a decision of the Tax Court of Canada in an appeal from a corresponding assessment under the Act.

CONCLUSION

Owing to the relatively mobile nature of trust income, the increasing top marginal tax rates in some provinces, and the game-changing decision in *Garron*, it is possible that in the future there will be an increase in the number of provincial trust residence cases. This will be an interesting area to watch, particularly if the provincial superior courts—as might be expected, given the CRA's ongoing interprovincial tax-avoidance audit project—are left to develop the post-*Garron* law of trust residence without further guidance from the Tax Court of Canada and the Federal Court of Appeal.

In my view, the decision in *Garron*, when read together with the decisions in *Velcro* and *Prévost Car*, creates a framework for establishing control over trust property, and thus locating central management and control of a trust. The fact that

104 *Supra* note 36.

105 I assume that if the CRA's Appeals Division determined that the trust was a sham or that subsection 75(2) applied, the federal income tax paid by the trust would be applied against the resulting federal income tax liability of the settlor or would be refunded to the trust, as the case may be. If this were not the case, the liability of the settlor under the Act would also be a critical issue.

106 *Holmes*, *supra* note 99, at paragraphs 15-16, 46, and 48.

control relates to property, and not to underlying corporate activities or the intentions of the settlor, means that a determination of who has control of trust property should be relatively mechanical. As is the case with corporate residence, there is no basis for the application of the central management and control test as an interprovincial anti-avoidance rule for trusts.

It is impossible to predict whether the change from a trustees' residence test to a central management and control test for trust residence will curb any of the abuses perceived by the CRA, once taxpayers familiarize themselves with the central management and control test and how it may be manipulated, but this seems unlikely. It is my expectation that, given further guidance from the courts, taxpayers will become adept at establishing central management and control in desirable jurisdictions, and trust residence cases will become as infrequent as corporate residence cases post-*De Beers*. Time, however, will tell.

