

THE UNIVERSITY OF BRITISH COLUMBIA
PETER A. ALLARD SCHOOL OF LAW

FINAL EXAMINATION – APRIL 2020

LAW 410.001
International Taxation

Professor David Duff

EXAMSOFT PASSWORD:
EXAMSOFT RESUME CODE:

TOTAL MARKS: 100

WRITING TIME ALLOWED: 3 HOURS
PREPARATION TIME ALLOWED: 10 MINUTES

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LAW 410

This exam consists of two questions, each of which is worth 50 marks. Allocation of marks within each question is indicated in square brackets after each question. Please answer both questions and limit your answers to 2,000 words for each question.

QUESTION 1

Justin Buber is a singer, songwriter and actor, who was born in London, Ontario, in 1994. In 2010, Buber released his first studio album, *My Hair*, which was followed by a world tour which made him an international star. Since then, Buber has become one of the world's best-known musical artists, releasing several best-selling albums, performing in regular concert tours, and acting in television and movie roles. He has also capitalized on his fame by endorsing several products, including several fragrances and a line of "Buberwear" clothing produced by Canadian designer Calvin Clone, for which he received royalties from Clone's Canadian corporation, Calvin Clone Limited ("CCL"). By the beginning of 2016, Buber's net worth was \$160 million, much of which was attributable to accrued gains on publicly-traded securities in which Buber had invested income that he had derived from music sales, concert tours, acting roles and endorsements.

Until June 2012, Buber lived in Stratford, Ontario, with his mother and her parents. After graduating from high school in 2012, however, Buber moved to California, where he rented a 6,000 square-foot residence in a gated community near Malibu, and obtained a drivers licence and a temporary resident visa for entertainers. Over the next three years, however, Buber never spent more than 100 days a year in the U.S., since he was on tour for seven or eight months a year and spent summers in Stratford, Ontario, where stayed at a mansion that he purchased for his father in 2013. During these years, Buber filed tax returns in Canada as a resident person and tax returns in the U.S. as a non-resident person, including his income from U.S. sources for U.S. tax purposes and including his income from all sources for Canadian tax purposes, against which he claimed foreign tax credits for business-income taxes and non-business-income taxes paid to the governments of other countries.

In the fall of 2015, Buber decided to take a break from touring and spend more time in California, where he had begun a relationship with U.S. model and television personality Hilary Baldwin, and had been hired for roles in several movies, including *Zoolander 13*. After he and Hilary were married in January 2016, Buber applied for U.S. citizenship, which was granted later in the year, making him a dual citizen of Canada and the United States. He and Hilary also decided to purchase a 10,000 square-foot mansion in Beverly Hills, California, to which the couple moved when they obtained possession of the property in February 2016. Although Buber returned to Canada with Hilary in July, 2016, when he rented a summer house on Lake Muskoka north of Toronto for a month, he did not file a Canadian tax return for 2016, but instead filed a U.S tax return as a resident of the United States.

Following several months in a Los Angeles recording studio, Buber released his fourth studio album in November 2016, after which he commenced a worldwide concert tour that lasted throughout 2017. In order to manage the tour, Buber incorporated a wholly-owned U.S. company called Buberworld Enterprises Inc. ("BEI"), with which he entered into an employment agreement

under which he would be paid 95% of the net receipts from the concerts computed before the deduction of this remuneration. Of 100 concerts in the tour, 8 were held in Canada, which generated gross revenue of \$15 million out of total revenue of \$150 million from all concerts in the tour. Of 350 days from the beginning to the end of the tour in 2017, Buber was in Canada for a total of 35 days, including a week visiting his parents in Stratford, Ontario, and two weeks at a summer home that he and Hilary rented on Lake Muskoka. In computing its income for U.S. tax purposes in 2017, BEI reported net receipts of \$80 million before the payment of any remuneration to Buber, and net income of \$4 million after deducting remuneration of \$76 million paid to Buber under the employment agreement. In computing his income for U.S. tax purposes for 2017, Buber reported employment income of \$76 million from BEI. Neither Buber nor BEI filed Canadian tax returns for 2017.

After the 2017 tour, Buber decided to take another break from touring in order to work on a 10-part documentary about his life and career, which was produced in Los Angeles and released in 2019. After filming most of the segments in Los Angeles from January to May 2018, he and Hilary spent three months in Canada, where he purchased a mansion near Stratford, Ontario (the "Stratford mansion") in June. In late August, Buber and Hillary returned to Beverly Hills, where Buber spent the fall of 2018 working closely with the director on production of the documentary.

Buber received a notice from the Canada Revenue Agency (CRA) earlier this year, asking him to file Canadian tax returns as a resident of Canada for his 2016, 2017 and 2018 taxation years. BEI also received a notice from the CRA, asking it to file a Canadian tax return reporting its income from the concerts held in Canada during Buber's 2017 concert tour. In response to these notices, Buber's Los Angeles accountants have contacted you in order to advise them on how Buber and BEI should respond. Specifically, they would like to know the following:

- (1) was Buber a resident of Canada for Canadian tax purposes in any of the 2016, 2017 or 2018 taxation years? [10 marks]
- (2) if Buber was a resident of Canada in any of these years, how would his Canadian tax be computed? [10 marks]
- (3) if Buber ceased to be a resident of Canada in 2016, what, if any, Canadian tax consequences could result from his emigration from Canada? [4 marks] and what, if any, Canadian tax consequences could result if he became a resident of Canada again when he purchased the Stratford mansion in 2018? [4 marks]
- (4) if Buber ceased to be a resident of Canada in 2016 and was not a resident of Canada in 2016, 2017 and 2018, what, if any, Canadian tax might be payable by Buber in respect of royalties from the sale of music in Canada [4 marks] or royalties from the endorsement of Buberwear clothing designed and sold by CCI? [4 marks]
- (5) if Buber ceased to be a resident of Canada in 2016 and was not a resident of Canada in 2017, what, if any, Canadian tax might be payable by Buber in respect of the concerts held in Canada as part of his 2017 concert tour? [8 marks] and
- (6) what, if any, Canadian tax might be payable by BEI in respect of the concerts held in Canada as part of Buber's 2017 concert tour? [6 marks]

In your answers to these questions, please refer to relevant provisions of the Canadian *Income Tax Act*, as well as relevant judicial decisions and provisions of the Canada-U.S. Tax Treaty.

QUESTION 2

Brookstone Investments, PLC (“Brookstone”) is a private limited company that was incorporated in Bermuda in 2008 as a vehicle for investment by high net worth individuals, most of whom are residents of the the United Kingdom. Bermuda is a British Overseas Territory with its own laws and tax system, which does not levy any corporate income tax and has not entered into any tax treaties.

Oxbridge Properties Ltd. (“OPL”) is a Canadian company which carries on a commercial real estate business in Canada, earning income from the acquisition, development, management and sale of commercial real estate in Canada. Incorporated in Ontario in 1996, OPL is managed by a board of directors that meets in Toronto four times a year. Until 2016, all the shares of OPL were held by the Ontario Municipal Employees Retirement System (OMERS), a pension fund established by the Government of Ontario to manage retirement benefits of provincial and municipal employees in Ontario.

In 2011, OPL borrowed \$1.5 billion from Brookstone in order to construct an office complex in downtown Calgary called Centennial Plaza. Under the loan agreement, OPL agreed to pay interest on the debt at an annual rate of 4%. At this time, Brookstone and OPL dealt with each other at arm’s length.

By the time that Centennial Plaza was completed in 2015, oil prices had fallen and the market for Calgary office spaces had collapsed, resulting in a commercial vacancy rate of 25%. Although OPL managed to find a few tenants for the complex, 60% of the office spaces remained vacant by the end of the year, resulting in substantial operating losses. As a result, OPL approached Brookstone in order to restructure the loan.

Following difficult negotiations, Brookstone agreed to convert \$500 million of the debt into 5 million OPL shares worth \$100 each (\$500 million in total), and to lower the fixed interest rate on the outstanding \$1 billion loan (the “Brookstone debt”) to 3% on the condition that Brookstone would also receive participating interest on the loan equal to 25% of any net operating surplus from Centennial Plaza after the deduction of fixed interest payments and other expenses. As a result of this restructuring, which came into effect on January 1, 2016, Brookstone held 25% of the voting shares of OPL, the paid-up capital of which was equal to the principal amount of the converted debt of \$500 million.

Immediately after this restructuring, Brookstone assigned the Brookstone debt to a wholly-owned U.S. subsidiary called Brookstone Capital Inc. (“BCI”) which it had incorporated in 2010 as a vehicle for investments in the United States. Under the terms of this assignment, BCI had the right to receive all interest on the Brookstone debt, but agreed to pay Brookstone an amount equal to the interest that it received on the loan no later than 30 days after the receipt of this interest from OPL. In the interim, BCI was free to invest the funds at it wished, together with its other investments.

Although OPL paid fixed interest of \$3 million on the Brookstone debt in 2016, Centennial Plaza continued to incur losses that year, as a result of which no participating interest was payable. As oil prices increased in 2017, however, OPL was able to find more tenants for the building and reported a net operating surplus of \$4 million, as a result of which it paid BCI fixed interest of \$3 million and participating interest of \$1 million. Consistent with the terms of the assignment of the Brookstone debt, BCI paid Brookstone \$4 million in 2017. In computing its income for its 2016 and 2017 taxation years, OPL deducted the full amount of the interest that it

paid to BCI. OPL did not withhold and BCI did not pay any Canadian tax in respect of these interest payments.

With the losses from its Centennial Plaza project, OPL's board of directors decided that the company should not pay any dividends in 2016. As circumstances in Calgary improved and the value OPL's properties in other Canadian cities increased, however, the board decided to pay a substantial dividend of \$5 per share on December 1, 2017. After the board had approved the dividend, but before it was paid, Brookstone held a board meeting in London, England, where it announced that the board, which had previously met only in Hamilton, Bermuda, would thereafter meet only in London, England. Of the \$25 million dividend that it paid to Brookstone, OLP withheld 5% of this amount (\$1,250,000) on Brookstone's behalf on account of Canadian tax payable under Part XIII of the ITA.

The next year, Brookstone decided to sell its OLP shares, which had increased in value substantially since 2016. After considering several offers, Brookstone eventually sold the shares to OMERS for \$750 million. OMERS did not withhold and Brookstone did not pay any Canadian tax on the gain from the disposition of these shares.

You have been engaged by the CRA to review these transactions in order to determine if BCI, Brookstone, OLP and OMERS have withheld or paid the appropriate amount of Canadian tax. Specifically, the CRA would like to know the following:

- (1) could the thin capitalization rule in subsection 18(4) apply to limit the deduction of interest expenses incurred by OLP on the Brookstone debt? [10 marks]
- (2) should OLP have withheld and BCI paid tax on interest that OLP paid and BCI received on the Brookstone debt, and, if so, at what rate? [15 marks]
- (3) could Brookstone have been subject to a higher rate of tax on the dividends that it received from OLP? [10 marks]
- (4) should OMERS have withheld and Brookstone paid any Canadian tax in respect of the gain that Brookstone realized on the sale of its OLP shares to OMERS? [15 marks]

In your answers to these questions, please refer to relevant provisions of the Canadian *Income Tax Act*, as well as relevant judicial decisions and treaty provisions. In addition, please explain whether BCI was the beneficial owner of interest payments that it received from OLP and, if so, whether it could claim benefits under the Canada-U.S. Tax Treaty, whether Brookstone could claim benefits under the Canada-U.K. Tax Treaty in respect of the dividends that it received from OLP and the sale of its OLP shares to OMERS, and whether the GAAR might apply to any of these transactions?

END OF EXAMINATION