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Source of Income and Canadian International Taxation

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Introduction

The 1917 Income War Tax Act ("the 1917 IWTA")[1] and the current Income Tax Act[2] establish Canada's tax jurisdiction by reference to the residence of taxpayers and particular associations with Canada of income earned by non-residents. These associations, we observe, generally either reflect comparisons with the relevant circumstances of similarly situated Canadian residents or involve payments made by Canadian residents for the use of non-residents' tangible, intellectual, and financial property or for services. In the residence-source paradigm that grew out of the post-First World War study of international taxation under the auspices of the League of Nations, source was, in a sense, in the shadow of residence.[3] Still, it does seem fundamental that in constructing an income tax base that can withstand competing sovereign tax claims, establishing with some precision, predictability, and reliability where income "originates" and who "owns" it necessarily would be primary design objectives.

The current Act uses the term "residence" more than 100 times and defines it with considerable particularity.[4] In contrast, the word "source" is used only a few times and never in a charging provision. The Act does not define what "source" means or contain specific source rules.[5] None of the major tax reforms has concerned itself much with precise territorial source rules. The Royal Commission on Taxation (the Carter commission) had little to say on the subject,[6] and the Technical Committee on Business Taxation said nothing.[7] The question of source was broached, given the potential risks to the Canadian tax base posed by electronic commerce (now the digital economy), in the minister of national revenue's 1998 report on the implications of e-commerce for the integrity of the Canadian tax system.[8] The 2008 advisory panel's study of Canada's international tax rules[9] did not address the territorial source of income, although it noted that the matter is important and should be reviewed. There is not much literature on the notion of source and source rules.[10]

If source is such a pillar of international tax jurisdiction, how can it, as a notion, be so strikingly absent from not only the IWTA but also the Act, in their various versions? In jurisdictional terms, how was it foreseen that the "Canadianness" of income would be established? How is the notion of source reflected in the

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legislation—that is, what is the Canadian approach to source? What underlies the Canadian approach? Can this approach continue for another 100 years?

In this paper, we investigate these questions by examining the evolution of the Canadian international tax system, legislative schemes and provisions that reveal the underlying convictions about source, and parliamentary debates on the IWTA as recorded in Hansard, which, compared with the present, were surprisingly probing and substantive.[11] Our preliminary conclusions are as follows:

1) Source is fundamentally a legal notion, serving a primary jurisdictional function.
2) Within the residence-source paradigm, the connotations of source and by them its meaning for the purpose of Canadian income taxation are established with reference to, or are infused by, residence as a marker of tax jurisdiction.
3) No version of the statute, from 1917 to the present, defines source or prescribes source rules. Instead, the statutes describe the observable circumstances of how income is earned or originates. In effect, Canadian tax law is concerned with the origin of income, functionally or as established by the private law that activates that income. These circumstances indicate the income's "real and substantial link" with Canada.[12] When such income is "legally" diverted away from the Canadian tax base, the IWTA and the Act apply anti-avoidance rules to preserve the notion of source.
4) The core notion of source assumed by the IWTA and the Act implies that Canada sees itself as a co-venturer with taxpayers in earning income.
5) The Canadian approach to establishing source reflects consistent and reliable themes and tendencies. Viewed from the perspective of explaining source, or possibly more accurately "tax origin," that approach is simple systemically, but it is not simplistic or, in tax policy terms, naïve or too forgiving.
6) Although the Act, in its various versions, has functioned well for 100 years without clear prescriptions about source, the status quo is under serious challenge in the age of increasing globalization and digitization. In particular, Canada's historical reliance on establishing the source of income by description may be strained by the functional dissociation of income from the kinds of observable income-earning activities occurring or being deemed to occur "in Canada" that are contemplated by Canadian law, which increasingly are possible through the confluence of legal constructions according to which income-earning activities are organized and opportunities are available for the virtual conduct of business.

An evaluation of the Canadian notion of source at the juncture of the Act's centennial anniversary is timely and important. The circumstances are of course different now from those of 1917. The transaction of business digitally, affecting both producers and consumers of products and services, allows income and those who earn it to be, effectively, everywhere and nowhere at the same time. The natural associations of income and taxpayers with places, once taken for granted

as established by force of circumstances, are less reliable and possibly more malleable and manipulable than ever before. The recent inquiry into base erosion and profit shifting (BEPS) undertaken by the Organisation for Economic Co-operation and Development (OECD)[13] was inspired by and is largely devoted to how the source of income is to be determined and how readily income may be re-sourced by employing legal constructions the fiscal significance of which, again, has been taken for granted. The BEPS project has prompted even more penetrating questions about whether income arises from production or from sales, and whether this affects the allocation of international taxing rights among countries, particularly where the income of multinational enterprises is involved.

More importantly, a solution to the issue of source is not self-evident. The current debate about BEPS focuses essentially on the source of income as a determinant of how taxing rights among nations should be applied. The BEPS recommendations may do no more (though this is still a laudable development) than detect where the source of income *is not*, by the articulation of negative source rules that leave it to be determined how residence countries should exercise their taxing rights, in much the same way as they would in the absence of the non-transformative intervention of legal constructions that may obscure where income is earned—that is, what its affirmative source would be determined to be.[14] In effect, negative source rules are the inverse of affirmative source rules in a world where general agreement on affirmative rules would likely be difficult, if not impossible, to achieve. Put another way, the BEPS work may be seen as a means, applying legal analysis as much as the limitations associated with "economic substance," to downplay the fiscal significance of legal constructions without jettisoning either those constructions or the arm's-length standard that relies on them. But even if a BEPS-induced revision of what source means by illustrating what it does not mean is effective, is this enough, particularly given the facility with which global trade in intangibles and services may be conducted virtually?[15] We suspect not. The time may have come for Canada to re-examine the notion of source and clearly articulate what makes income "Canadian." We suggest that a Canadian approach, once articulated, may be a better solution.

In the rest of this paper, we first provide an overview of the notion of source and Canadian tax jurisdiction. We then review the evolution of the Canadian international tax system and the legislative expressions of source, and conclude that source is a legal construct in Canadian tax law. Finally, we examine how source has been conceptualized in the evolution of the Act and suggest a reconceptualization for the future.

Source and Canadian Tax Jurisdiction

The Notion of Source

As a general notion, income has a source in a particular place (a country) when there is a sufficient connection to warrant the assertion by that country of a tax claim that it ultimately expects to be able to sustain and enforce. There are competing theories about the significance—indeed, the logical and analytical integrity—of source as a fiscal notion.[16] On the one hand, it is said that source simply manifests a country's assertion of tax sovereignty, otherwise unlimited by public international law. This force majeure theory—in effect, tax by might—equally denies the existence of an intrinsic geographic aspect of income and questions the economic coherence of source as a substantive notion. Another approach considers the correspondence between the source of income and the situs of property, taking particular account of the general law concerned with establishing the situs of property, including legal claims existing apart from the ownership of the means to pay them, which are enlivened—that is, constructively located in places—by the nationality of the law that governs them.[17] Even so, it seems that there is not a likely or empirically compelling association of source and situs. Finally, another school of thought concludes that source rules are, and are valuable as, rules of law; essentially, they reflect evidence-based legal conclusions about the relative significance of connections of income-generating activity to one jurisdiction or another as the basis for asserting and expecting to sustain a sovereign tax claim.

Despite competing theories, source is not self-defining. It conflates a variety of fiscal notions and imperatives. It is associated with the exercise of tax sovereignty in both absolute constitutional- and public international-law terms, taking account of the competing tax sovereignty of other nations. It describes the circumstances in which, functionally and operationally, income may be considered to be earned. It may also describe the legal domicile of a commercial claim, which is given a life of its own by private law and may be enforced regardless of how the performance of the claim might be funded in reality. Sometimes source is equated with the situs of activities, property, and means of enforcement relating to how an amount of income arises.

Source is fundamentally a legal jurisdictional notion. The word "source" and its companions "earned" and "arises" are commonly encountered in taxation, particularly where potentially intersecting tax claims of two or more countries need to be resolved. The IWTA and the Act rely on the notion of source in establishing the Canadian tax base. To our mind, the theoretical justifications for validating the exercise of tax jurisdiction are less important than the underlying thrust of all the above-noted theories, which is to determine the origin of income—its nationality, so to speak—according to what the Tax Court of Canada recently referred to as "a real and substantial link"[18] to a taxing jurisdiction, cognizable by reference to public international law, convention, and customary practice.

"Source" in the Shadow of "Residence"

The Act consistently perceives the "Canadianness" of income by implicitly referring to its "real and substantial link" to Canada.[19] The Act does so, and has always done so, without using prescriptive rules to establish the source of income in relation to non-residents or to validate the non-Canadian source of

income in relation to Canadian residents who expect their foreign and Canadian tax liabilities to be reconciled without excessive taxation. Legislators have been mostly concerned, not with arcane public finance theory or parsing difficult law concerning the ownership of property, but with how income is earned, including income earned by non-residents in circumstances that are substantially equivalent to those of similarly situated Canadian residents. In effect, the Act is concerned with the origin of income, functionally or as established by private law, which,

- activates (that is, "creates" or "unleashes") that income with reference to legal considerations that are a particular manifestation, themselves, of the "home" of that income; and
- infuses the notion of source of income with connotations associated with the residence of taxpayers—either similarly situated resident taxpayers or resident taxpayers who are the medium and means by which the value of property owned by a non-resident is harvested through Canadian usage.

The Act effectively characterizes income as Canadian or not according to this notion of source.

Source has been in the shadow of residence in the residence-source jurisdictional paradigm. In the entire history and conversation about Canadian income taxation, little is said about source except in relation to the sometime arcana of computing the foreign tax credit. In a global context, however, source is a key part of international tax development.

During the period of post-First World War reconstruction, the newly formed League of Nations undertook an examination of intersecting national tax claims, notably concerning the possibility that trade would be distorted by double taxation. Double taxation would occur if and to the extent that countries pursued their otherwise unrestricted taxing rights, since public international law does not restrict the assertion of broad fiscal sovereignty and only restricts extraterritorial enforcement. What emerged from the League of Nations' work was the enduring paradigm for sharing the taxation of international income with reference to the residence of taxpayers and the source of their income.[20] Edwin Seligman was one of four distinguished economists appointed by the League to captain the project. It is fair to say that his work had not only a direct impact on the international tax paradigm but also an indirect impact on Canadian tax law, in that it influenced the development of US income tax law, which in turn influenced the IWTA.

It was in the context of the evolving international tax paradigm that the jurisdictional notions for taxing international income were formed in the IWTA when it was enacted and in several subsequent stages. And yet the IWTA avoided using the term "source" and any prescriptive source rules. Instead, the IWTA was drafted, first, to reflect the reality of how non-residents earned income in Canada, particularly from carrying on business; second, to accommodate, by way of crediting, taxes paid by Canadian residents to Great Britain (of which

Canada was then a colonial extension) and to other countries on a reciprocal basis; and third, to deal with the reality of tax enforcement. The approach adopted in the IWTA was to describe the circumstances in which income was taxable by Canada and the circumstances in which Canada would cede its tax claim to another country.

"Source" by Example: The Pedigree

The basic legislative scheme for Canadian taxation of "international income" was an original feature of the IWTA in 1917 and was, but for its withholding tax aspects, more or less fully formed by 1924. Subsequent changes essentially refined the application of this scheme or were intended to protect it against the perils of what would now be called base erosion and profit shifting.[21] The scheme is quite straightforward in design, reflecting a set of convictions about what should be in the Canadian tax base and a set of coherent policies that broadly adhere to the residence-source paradigm. It has functioned for 100 years without any explicit source rules. "Source" as a developed tax-law construction did not exist. Presumably, any need to further parse the legal origins of income would be determined, if assistance or definition were required, by the private law on which tax law, even then, rested (private law being the law that accounts for the meaning and significance of relationships and constructions in respect of which the tax law exacts consequences).

The IWTA reflected an awareness of source as a jurisdictional, even possibly a territorial, notion and seemed to presume an understanding of what source meant or what the scope of the Canadian tax jurisdiction should be. It avoided the need for a precise definition of source by describing the scope of the tax base by way of examples. Subsection 4(1) of the 1917 IWTA imposed tax on a non-resident's income from "carrying on any business in Canada." In 1918 and 1919, the IWTA was amended to tax a non-resident "employed in Canada" (subsection 4(1)) and to explain the meaning of "persons employed in Canada" by reference to various forms of compensation "from sources within Canada for personal services . . . performed in Canada" (section 2). The focus was on where the employment services took place, an empirically determinable matter that establishes a clear connection without which the income would not have been earned. There are other possibilities, which in other circumstances the private law to which tax law is accessory might consider to be respectable. For example, tax jurisdiction could be based on where the claim to be paid employment compensation could be enforced, which could be a jurisdiction other than the one in which the employment services were performed.

Another example is the nascent foreign tax credit enacted in 1919 as the new subsection 4(5), which referred to income derived from sources in Great Britain or a foreign country. The notion of derivation was broad and focused on the existence of the tax, though taxpayers seeking this relief were required to "furnish evidence satisfactory to the Minister showing the amount of tax paid and the

particular of income derived from sources within Great Britain or any of its self-governing colonies or dependencies or any foreign country." The IWTA provided little help, or even recognition of the need for help, in establishing the source of income. All income of residents was captured by the tax base, and the renunciation of tax otherwise due was essentially established by the fact that the tax had some demonstrable connection to the other jurisdiction's basis for asserting it.

Two other examples can be offered to like effect. One is the reference in the charge to tax in section 3 of the 1927 IWTA[22] to income "derived from sources within Canada or elsewhere" but in that context expressing indifference as to the conclusion. Another example is the precursor to the present foreign shipping exemption for Canadian residents—an exemption enacted in 1927-28 for non-residents that otherwise would be considered to be carrying on business in Canada. This exemption, in paragraph 4(m) of the IWTA, was framed with reference to a functional awareness of the realities of the shipping industry that made point-in-time connections of essentially continuous and seamless income-earning activities hard to establish, but equally an awareness that some accommodation to the realities of shipping was necessary to facilitate trade, as long as the accommodation was in some sense fair. Eligibility for the exemption was to be determined with reference to where the ships were registered. This established a bright-line test consistent, presumably, with how the shipping industry operated—and, indeed, continues to operate—reflecting the reality of that business, which might elude other theoretical or functional notions of source.[23] The exemption was available, however, only if the country of registration would offer reciprocal relief to Canadian mariners. The focus on reciprocity here and in the foreign tax recognition context reflected Canada's awareness from the outset that jurisdictional determinations and concessions are not absolute, and fundamentally are guided by an awareness of where income originates and the reconciliation of otherwise possibly absolute tax claims, subject to public-law limitations on enforcement.

Reflecting its pedigree in the IWTA, the current Act rarely uses the word "source." The heading of section 4 (which, of course, has no legislative significance) refers to the "source" of income. The provision itself, however, refers to four *qualities* of income (from an office, employment, business, and property) and income from "other sources." It then refers to those "sources [being] in a particular place" and instructs that income from an office, employment, or business be computed with reference to each *place* where the income-generating activities occur.

The foreign tax credit regime in section 126 is no more revealing of what the Act has in mind for source as a construct. Section 126 (and its analogue in the foreign affiliate regime) offers credit for foreign business-income and non-business-income tax determined by the payment of tax to another country in relation to business conducted there or income originated there. In other words, the locational features of income in section 126 are established by the fact that foreign tax is paid, implicitly segregating foreign tax claims by political geography, but not otherwise specifying how the association of the income with that geography should be determined. In this context, the Act does concern itself with the determination of a requisite amount of income, taxable income, and Canadian tax in relation to the foreign tax to sustain foreign tax recognition. That determination has recently been refined with specific attention to (1) whether economic income exists and expenses have been properly aligned with revenue to compute income; and (2) whether there are transactional or organizational features of the arrangements ostensibly responsible for foreign tax that affect whether there is in fact any related Canadian tax or, taking account of the foreign law, any foreign tax that should be recognized as a reduction of Canadian tax (the so-called foreign tax credit generator rules). These refinements do not alter the basic jurisdictional parameters of the IWTA for taxing international income, nor do they inform what "source" means.

Evolution of Canadian International Tax Rules

Milestones

The 1917 IWTA laid the foundation for and set the tone of Canadian tax jurisdiction. The framework for taxing non-residents was established by 1933 and has remained more or less intact. The framework for taxing Canadian residents on the basis of the principle of worldwide taxation was instituted in 1917, and the technical system was revamped in 1971 to more or less reduce that principle to the taxation of income from capital. Complex rules were subsequently added to refine, without fundamentally changing, the basic framework and policy underpinnings of the IWTA. Capital gains realized by non-residents from "taxable Canadian property" became taxable in 1972. Most changes reflected the legislators' persistent concern, from the outset, to mitigate the dissipation or erosion of the tax base through the use of legal devices that transformed the character of otherwise taxable income and allowed its value to be realized beyond the legislated reach of the statute.

The 1917 IWTA provided in subsection 4(1) that tax would be assessed upon the income of every person resident in Canada or carrying on any business in Canada. Association with Canada described by reference to Canadian residence and an income-earning activity (carrying on business in Canada) remains a foundational feature of today's system. No rules to prevent double taxation of foreign income earned by Canadian residents were provided in the 1917 IWTA; these came later. Initially, the IWTA acknowledged and deferred, more of less without qualification, to tax levied by Great Britain. In the case of other countries, it required reciprocity, a principle that has since been enshrined in modern tax treaties.[24] Subsequent amendments provided for the taxation of other types of income of a non-resident, in addition to income from carrying on business in Canada (referred to in this paper as "COBIC income"). The 1917 IWTA did, however, contain a transfer-pricing rule, formulated as a "fair pricing rule," which foreshadowed the law's persistent and underlying concern with distortions

of taxable income attributable to the effects of legal constructions intervening between income and its owners and, more generally, with base erosion.[25]

Amendments to the IWTA between 1918 and 1940 included, among other important changes,

- extension of the jurisdiction to tax non-residents employed in Canada or rendering services in Canada (1918, 1919);
- expansion of the concept of carrying on business in Canada by including non-residents who solicited orders or offered anything for sale in Canada and non-residents who rented anything for use in Canada or who received royalties for anything used or sold in Canada (1927);
- the introduction of a foreign tax credit (1919); and
- the introduction of a gross basis withholding tax on dividends, interest, rents, and royalties paid to non-residents (1933 for interest and dividends, and 1940 for rents and royalties).[26]

By 1933, the essential and continuing features of the inbound system (other than the capital gains element) were established and more or less fully formed conceptually.

From 1938 to 1971, the outbound rules underwent some changes. In 1938, dividends received by Canadian corporations from their foreign subsidiaries became exempt, subject to certain limitations. In 1941, an indirect foreign tax credit was introduced for dividends from foreign subsidiaries that did not qualify for the exemption. In 1960, the branch tax was introduced to provide equivalent withholding tax on after-tax profits of a non-resident from carrying on business in Canada through a branch or a subsidiary corporation.

In reaction to the recommendations of the Carter commission, the Income Tax Act was significantly amended in 1971[27] by introducing, among other changes, a new structure for the taxation of Canadian corporations' foreign income and a tax on capital gains. In addition, the format of the statute was changed and many sections were renumbered, including those governing the taxation of non-residents. Since 1972, changes to the Act have been primarily concerned with anti-avoidance rules to protect Canada's jurisdictional claims.

The parameters of the Canadian international tax system seem to have been drawn in 1917 without much debate in Parliament. The system adopted was consistent with the paradigm developed by the League of Nations, an international context of which Canada presumably was aware even if it was not directly involved in the formulation of that paradigm or its formative stages of study. The federal approach to income taxation was also consistent with the existing provincial and municipal taxation of income in Canada.[28] Tax luminaries, such as Edwin Seligman and T.S. Adams of the United States, were influential.[29] More specifically, the newly reintroduced federal income tax in the United States[30] ("the Revenue Act of 1913") imposed taxes on the basis of the personal connection between a taxpayer and the United States and the territorial source connection between income and the United States. Canada evidently was aware of developments in the United States and adopted certain concepts contained in the Revenue Act of 1913, but seemingly opted for technical instruments of the sort used in the United Kingdom. While the Revenue Act of 1913 adopted citizenship as a personal connection factor, US constating law for corporations, and all US sources of income for foreign corporations, the UK tax act adopted residence and engaging in trade within the United Kingdom.[31]

Canada, owing to its place in the world, has been both exposed to international fiscal ideas and influences, and made vulnerable to them. To some extent, Canada has needed to adapt to prevailing fiscal and economic developments. From 1917 to the early 1990s, Canada had been a net capital-importing country. When the 1917 IWTA was enacted, foreigners viewed Canada as a promising developing economy.[32] Much investment came from the United Kingdom and the United States, and Canada was active in engaging in cross-border trade and investment. The need to make the Canadian tax rules in some sense competitive appears to have influenced Canada's approach to income taxation, particularly the taxation of business income, including COBIC income. The 1917 IWTA sought to tax foreign corporations only on their COBIC income, while the US Revenue Act of 1913 taxed all US-source income, including investment income. The Canadian withholding tax was not introduced until 1933, and when it was introduced, the tax rate was only 5 percent, as compared with the US rate of 8 percent.[33] Canada sought to secure a global advantage in attracting investment capital, especially with respect to the United States.[34] The exemption system for foreign business income earned through foreign subsidiaries was also justified on the basis of tax competitiveness.[35]

Canadian Residents' Foreign Income

Unlike the United States or the United Kingdom, Canada did not opt for citizenship or domicile as a basis of tax jurisdiction; it chose residence. A Canadian resident's taxable income includes income "derived from sources within Canada or elsewhere"(subsection 3(1) of the 1917 IWTA). The taxation of income from "elsewhere" raised two basic issues: how to recognize foreign taxes paid on that income, and how to deal with the separation of that income from its Canadian owner through the use of foreign intermediaries.

The 1917 IWTA contained no rules on the recognition of foreign taxes, although it was believed that foreign taxes would be deductible in computing a taxpayer's income.[36] As noted above, a foreign tax credit was introduced in 1919, in subsection 4(5) of the IWTA; its basic underlying tenets, a reduction in Canadian tax to accommodate the primary taxing rights of, initially, Great Britain and its dependencies, and other countries offering a reciprocal accommodation, foreshadowed, fairly completely in conceptual terms, the present section 126.[37] These features of the original foreign tax credit reflect an amalgam of what now is achieved unilaterally under the Act and reciprocally by treaty.

Under the current foreign tax credit system, generally foreign income taxes are creditable against Canadian tax otherwise payable;[38] however, in the case of certain foreign income from property, the creditable amount of foreign tax is limited to 15 percent. To the extent that the amount of foreign tax is equal to the Canadian tax otherwise payable, the foreign income is not taxed again in Canada; thus, the effect of the foreign tax credit is the same as exempting foreign income from Canadian tax.[39]

The treatment of foreign income earned through foreign intermediaries has been one of the most complex issues in the Canadian international tax system. The 1917 IWTA was silent on this matter as an international tax issue, though its preoccupation with avoiding unwarranted tax deferral attributable to the legal separation of income from its owners was a seminal feature of the embryonic corporate income tax. That said, subsection 3(4) of the 1917 IWTA provided for an "inside income" accrual rule, which required a Canadian-resident taxpayer to include in income annually its proportionate share of the undistributed income of a corporation. There was no evidence that this rule was intended to apply to foreign corporations owned by Canadian residents.[40] Detailed rules to attribute foreign income earned by foreign intermediaries to Canadian-resident taxpayers and to provide relief from international double taxation were introduced after the 1972 tax reform. These rules distinguish between foreign property income and active business income.

Foreign business income was, and has remained, largely outside the Canadian tax base for Canadian residents, at least in fact if not also in important respects by design.[41] From the earliest days of the IWTA, income earned by foreign business corporations engaged exclusively in conducting foreign business was not taxable. As the Canadian income tax system matured, between 1926 and 1952, the forerunner of the foreign affiliate system excluded business and property income from a substantial (more than 25 percent) Canadian shareholder's income. The foreign tax on foreign income earned directly was creditable against Canadian income tax; at the outset, this was expressed and limited with reference to income originating in "Great Britain and its self-governing colonies or dependencies or any foreign country" (subsection 4(5) of the 1919 IWTA). At that time, presumably, Canada's main trading relationships were with Great Britain and the United States (from which Canada largely copied its income tax legislation), so that there was a close connection between a territorial parsing of tax jurisdiction for business income and trade.

Under the current Act, when a business is carried on in a foreign country by a Canadian resident through a foreign subsidiary (such that business income is earned indirectly by the resident), the foreign subsidiary is not taxable in Canada as long as it is a non-resident of Canada. Dividends received from the subsidiary must be included in computing the Canadian-resident shareholder's income (section 90). The territorial source of dividends is based on the residence of the corporation. This is the flip side of subsection 212(2). Furthermore, the Act allows specific deductions to a corporate shareholder that holds a minimum

10 percent equity interest, in computing its taxable income in respect of dividends received from a foreign affiliate. The extent of such deductions depends on the quality of income out of which the dividends are paid (that is, whether it is active or passive business income) and on the "designated treaty country" status of the foreign-source country.

In contrast, investment and like income of Canadian residents is taxable by Canada on a current basis, regardless of how it is earned (including through distinct legal personalities that are more or less the alter ego of Canadian taxpayers) or where it is earned (inside or outside Canada). Canadian residents should not be able to avoid or defer tax on income through private-law legal constructions, even if those constructions are not artificial, where there is no necessary connection between the taxpayers and how the income is earned. In default of an actual imputation of income when it is earned, taxpayers are accountable for a proxy for the income that reflects the nature of the taxpayer's expenditure, if only imperfectly.[42] This is the anti-income-diversion aspect of the Canadian tax system. Indeed, it was of principal concern to the political parents of the IWTA because the facility, so soon after *Salomon v. Salomon*,[43] with which a taxpayer could be parted from its income by a legal fiction, without in fact being parted from that income, dominated discussion in the House of Commons about holding companies, transfer pricing of a sort, and the like.[44] Except for the surtax applicable to individuals, corporate income generally was taxable on an undistributed basis to the corporation's shareholders, effectively erasing the legal separation of interests afforded by incorporation. The foreign accrual property income (FAPI) rules, discussed in more detail below, were designed to have a similar effect.

Non-Residents' Income from Carrying On Business in Canada

Canada has from the outset expected to tax non-residents who earn income in Canada, whether directly or from the use of their property, in much the same way as it would tax similarly situated Canadian residents. As discussed earlier, the 1917 IWTA identified carrying on business in Canada as the basis for Canadian jurisdiction to tax non-residents.[45] Subsection 4(1) stated:

> There shall be assessed, levied and paid, upon the income during the preceding year of every person residing or ordinarily resident in Canada or carrying on any business in Canada, the following taxes.

Hansard's record of pertinent parliamentary debates regarding the IWTA contains discussions about why a corporation was taxable and whether a non-resident person had to draw up a statement of the revenue from its Canadian business,[46] but no discussions about why a non-resident person was taxable on income from a business carried on in Canada (income that we have labelled "COBIC income"). It seemed to be accepted that COBIC income was taxable. As explained below, the concepts of Canadian corporate residence and carrying on business in Canada communicate the same notion of source: Canada is the location of business income. This income is taxable in Canada. The intention that Canada does not expect to tax foreign business income was more explicitly articulated by subsequent amendments. Legislative guidance on the meaning of carrying on business in Canada was first provided in 1924 and then 1994. Judging by the number of cases, the interpretation of the term has not been controversial in Canada.

In 1924, section 3 of the IWTA was amended by adding two deeming rules.[47] Paragraph 3(2)(b) stated:

> Where a non-resident person in whole or in part produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs anything within Canada and exports the same without sale prior to the export thereof, he shall be deemed to be carrying on business in Canada and to earn within Canada a proportionate part of any profits ultimately derived from the sale thereof outside of Canada. The Minister shall have full discretion as to the manner of determining such proportionate part.

Paragraph 3(3)(b) stated:

> Any non-resident person soliciting orders or offering anything for sale in Canada through an agent or employee, and whether any contract or transaction which may result therefrom is completed within Canada or without Canada, or partly within and partly without Canada, or any non-resident person who lets or leases anything used in Canada or who receives a royalty or other similar payment for anything used or sold in Canada, shall be deemed to be carrying on business in Canada and to earn a proportionate part of the income derived therefrom in Canada. The Minister shall have full discretion as to the manner of determining such proportionate part.

Paragraph 3(2)(b), with changes in wording, eventually became paragraph 253(a) of the current Act. Paragraph 3(3)(b), again with changes in wording, eventually became paragraph 253(b) and paragraph 212(1)(d) of the current Act.

Under paragraph 3(2)(b) of the 1924 IWTA (and now paragraph 253(a)), a non-resident who performed any of the specified activities in Canada was deemed to be carrying on a business in Canada. These activities involved a combination of labour, use of property (tangible, intangible, and real property), and natural resources. In Canada at that time, they were the dominant types of business activities for both resident and non-resident corporations. The jurisdictional connecting factors were labour in Canada, use of property in Canada, and supply of Canadian real property and natural resources. The destination of goods produced in Canada when they were sold was not relevant. The Canadian value was unlocked by the creative activity in Canada.

Under paragraph 3(3)(b) of the 1924 IWTA (and current paragraph 253(b)), a non-resident who solicited orders or offered anything for sale in Canada through an agent or employee was deemed to be carrying on business in Canada. The provision relies on two jurisdictional factors: the presence of the non-resident or the non-resident's agent in Canada, and Canadian customers. During the 1920s, in-person marketing and distribution was presumably an effective way of exploiting the Canadian market. The potential value of the Canadian market was unlocked by the solicitation activity in Canada.[48]

In 1994, the concept of carrying on business in Canada was expanded. Paragraph 253(c) was added[49] to deem a disposition of Canadian resource property, timber resource property, or real property (other than capital property) situated in Canada to be carrying on business in Canada. This provision merely confirms that the gain, or profit, from the disposition of Canadian real property has a Canadian origin for tax purposes.[50]

Non-Residents' Returns on the Use of Financial and Other Property in Canada

Rents and Royalties

The 1917 IWTA did not provide for a gross basis withholding tax on income of a non-resident that is commonly described as investment income. The predecessor of the current withholding tax system was more or less established by 1933. The first withholding tax requirement was introduced in paragraph 3(3)(b) of the 1924 IWTA, which became section 27 of the 1932-33 IWTA. It was not until 1940 that Canadian residents were required to withhold and remit tax from payments of rents or royalties to non-residents. In 1948, the general withholding tax was extended to apply to the following:[51]

- rents, royalties, or similar payments for the use in Canada of property, in respect of an invention used in Canada, or for any property, trade name, design, or other thing whatsoever used or sold in Canada; and
- payments for management, technical, professional, or other services, or for information or advice, knowhow, sales rights, or the right to use a patented or unpatented invention, process, or formula, "discovered or undiscovered . . . minus a reasonable amount . . . in respect of services actually rendered in Canada by the recipient's officers or servants" under the contract or arrangement for the services, information, advice, knowhow, or sales rights, or the use of the invention, process, or formula.

The current paragraph 212(1)(d) is more detailed, covering rents, royalties, or similar payments, including any payment for the use of or for the right to use in Canada "any property, invention, trade-name, patent, trade-mark, design or model, plan, secret formula, process or other thing whatever," as well as payment for certain information concerning industrial, commercial or scientific experience (knowhow) or for certain services of an industrial, commercial, or scientific character (technical services or showhow).

The qualitative notion of source is more complicated in respect of rents or royalties. Rents or royalties were originally conceived by the IWTA as income of a non-resident's business conducted vicariously in Canada through the use of the non-resident's property by a Canadian resident (paragraph 3(3)(b) of the 1924 IWTA).[52] The legacies of this approach are found in the deeming rule for rent under current paragraph 212(13)(a) and the net basis election under current section 216. Even when the tax was legislated in 1940 to be collected through withholding, arguably it did not change the way the income was seen fundamentally as business income. Without characterizing rents or royalties as "income from property," paragraph 212(1)(d) simply requires tax to be withheld from the payments. If a non-resident's rent or royalty is derived from carrying on business in Canada, the payment is taxable on a net basis under part I of the Act as opposed to being subject to gross basis withholding tax.[53]

The territorial source of rents or royalties has remained unchanged since 1924. Canada is the source because the property or "thing" was used in Canada, and regardless of the personality of the owner, it is that use that manifested a sufficient taxable presence—as if the property or thing were a constructive business presence in the nature of what tax treaties consider to be a permanent establishment.[54] The rent or royalty originates in Canada because the value of the property was unlocked by the use in Canada. While withholding is a procedural expedient for collecting tax from persons earning income in Canada but lacking resident status, Canada has from the outset perceived rents or royalties as income from carrying on business in Canada.[55] This way of thinking about rents or royalties may enlighten how income arising from intangibles or from the digital economy in the contemporary environment should be taxed.

Interest, Dividends, and Branch Profits from Canada

When non-residents invest their financial capital in Canada, the IWTA and the current Act regard Canada as the source of interest or dividends. The earliest withholding tax on dividends and interest is found in subsection 9B(2) of the IWTA (1932-33),[56] which stated:

> In addition to any other tax imposed by this Act an income tax of five per centum is hereby imposed on all persons who are non-residents of Canada in respect of
> (a) All dividends received from Canadian debtors irrespective of the currency in which the payment is made, and
> (b) All interest received from or credited by Canadian debtors . . . ;
> (c) All interest received by a non-resident parent company from a Canadian subsidiary company.

The term "Canadian debtors" was interpreted to mean "Canadian payers"[57]—that is, Canadian-resident corporations and other persons. The assumption was that the capital was used in Canada and the source of the interest or dividend was the place where the payer corporation used the capital. The branch profit tax under section 219 is a proxy for dividend withholding tax and is applicable when a non-resident corporation repatriates its after-tax COBIC income.

In this review of how significant dimensions of Canadian tax jurisdiction took shape, it is evident that the comparative reference for the kind and degree of taxation was residence. This is particularly the case with corporations earning COBIC income. In effect, in the expectation that interest payments to non-residents would reduce the Canadian tax base, the non-resident recipient was taxable, in rough terms, as if it were resident, even though the degree of taxation may be magnified by the fact that withholding tax is a tax on gross revenue. Implicitly, the relevance of the deductibility, in computing a resident's income, of payments made to non-residents effectively establishes an identity between the resident payer and the non-resident recipient for withholding tax purposes, which preserves Canada's tax base informed by how residents are expected to be taxed.[58] Residence generally, and corporate residence in particular, effectively functions as a proxy for source in respect of tax-deductible payments (rents, royalties, or interest).

Capital Gains from Taxable Canadian Property

The value inherent in Canadian real property and natural resources can be exploited by resident and non-resident taxpayers alike. The territorial connection between income from such exploitation and Canada was made clear as early as 1924. As discussed above, the 1924 IWTA listed mining in Canada and leasing property for use in Canada among the activities considered to be carrying on business in Canada; and since 1994, a disposition of Canadian real property or resource property has been deemed to be carrying on business in Canada.

When capital gains became taxable in 1972, gains from the disposition of a "taxable Canadian property" became taxable. "Taxable Canadian property" expresses the Canadian notion of source for capital gains taxation. This term was originally defined in paragraph 115(1)(b) of the 1972 Act[59] to include

> (i) real property situated in Canada, or an interest therein,
> (ii) any other capital property used [by a non-resident] in carrying on a business in Canada,
> (iii) a share of the capital stock of a corporation resident in Canada (other than a public corporation), or an interest therein.

The definition was subsequently expanded to include Canadian resource property and timber resource property.[60]

When Canadian real property, resource property, or timber property is owned indirectly through corporate entities or other intermediaries, the Canadian source is effectively preserved by treating shares of certain corporations as taxable Canadian property. To similar effect, section 6.3 was added to the Income Tax

Conventions Interpretation Act[61] in order to source capital gains from the disposition of taxable Canadian property to Canada for tax purposes where, through applicable private law, such capital gains could otherwise be re-sourced elsewhere so as to be considered not to arise in Canada as subsection 2(3) of the current Income Tax Act would require.

Concerns about enforcement and the potential impact on foreign investment resulted in the carving out of shares of public companies (unless a non-resident has a substantial shareholding in a company). In 2010, the scope of the definition of taxable Canadian property was narrowed in respect of shares. Previously, there was no requirement that more than 50 percent of the fair market value of those shares be derived from real property in Canada or Canadian resource or timber resource properties.[62]

Legislative Expressions of Source

Source Rules: Not Prescribed or Arguably Needed

As we have noted, the IWTA contained no specific source rules. The subsequent amendments to perfect the nascent income tax régime generally took for granted the source of income and proceeded to address other concerns associated with whether and to what extent income should remain taxable in Canada. It is plausible that the circumstances (indeed, the only circumstances) in which economic activity could take place supplied implicit source rules. We suggest that, at least historically, Canada did not need robust prescriptive source rules because little may actually turn on them.

As far as non-residents are concerned, Canada cares about, and likely will be able to establish, the Canadian origin of income either because the non-resident or its property, as the case may be, is observably in Canada. Essentially, the Canadian tax liability of non-residents is evaluated by simulating residence status with respect to and to the extent of the affected income. It has been this way since the earliest days of the IWTA. Canada expects to tax non-residents carrying on business or employed in Canada as if they were Canadian residents. By reason of how their income originates—how that income is linked observably or legally to their Canadian circumstances—it is presumed, and with no fanfare, to originate in Canada. The IWTA and the Act describe the circumstances of how a non-resident's income is earned or how it originates in Canada. This is the case, though possibly less clearly, even for income that is taxed through withholding. The condition for tax on income in the nature of a return on the use of money and other property is the use of that property, actually or constructively in Canada, directly by a Canadian resident that pays to use it and vicariously through that resident by the non-resident owner as if that owner presented itself in Canada as the Canadian-resident user of the property. The same kind of analysis applies with respect to the treatment of capital gains in the modern era of Canadian taxation. Under the current Act, non-residents are taxed on capital gains only to the extent that those gains arise from dispositions of real property or natural resource property in Canada, or may be assumed to be reflect the present value of property used in Canadian business operations, in both cases determined as would be the case for a resident.

The ways in which the IWTA and the Act describe the taxable amounts (or qualities of income included in the Canadian tax base) have an implicit source connotation: namely, where business is conducted; where employment functions are performed; where the value of Canadian land is extracted; where property income claims can be commercially enforced; and where, absent a cognizable direct presence of the non-resident in Canada, the non-resident's property is put to use in the only way possible to generate income, almost as if the property or the Canadian-resident user manifested the active presence in Canada of the non-resident. (We refer to these circumstances as "qualitative sources.") In these circumstances, the relevant private law and conflict-of-law principles generally regard Canada as the country of origin. Relying on Canadian-resident payers as "deputy tax collectors" in respect of investment income further reduces the need for precise territorial rules for inbound transactions.

The need for prescriptive source rules is also absent in the case of Canadian residents. Canada expects income from all sources—qualitative sources and foreign sources—to be taxable. The Act has a well-developed legislative scheme (such as the FAPI regime) that is designed to enforce that expectation, even where income is earned indirectly through legal constructions (corporations and trusts) formed and (nationally or actually) existing outside Canada. The exception is business income, the taxation of which is essentially fully conceded by Canada to other source countries through the direct foreign tax credit or the foreign affiliate regime. The origin of such income is seen as "elsewhere," not Canada. In other words, the Canadian tax system effectively reflects a division of territorial interest between Canada and "everywhere else." As far as non-business income is concerned, in the main, it does not matter that such income may originate elsewhere; it is taxable in Canada as though it had originated in Canada. While the precise location at which foreign business income is earned may be important for policing the recognition of foreign tax through the direct foreign tax credit, the existence of foreign tax with reference to relevant qualities of income may generally make locational uncertainty moot. The foreign affiliate regime is more blunt in this respect, ensuring that for the most part—with reference to trading relationships sufficiently important to warrant entering into tax treaties—foreign business income is tracked and measured as if Canada existed in a world of two jurisdictions: Canada and everywhere else.

In the result, the territorial source of income is generally not of great significance for Canadian residents except to determine, among qualities of income, how much credit Canada should give for tax paid to a foreign jurisdiction. Even that determination is, to some extent, self-executing insofar as the origin of the income will be evident by the mere imposition of foreign tax claims. While the territorial

source is important for recognizing—mostly crediting—Canadian tax on non-business income, the early source warning will come from the imposition of the foreign tax in the first place. Whether the foreign tax is an income tax, and its qualitative source, matter, but the territorial origin of the income can be expected not to be too doubtful, although in some hybrid cases cracks, to be filled, can emerge.[63] Consequently, apart from the assistance of conflict-of-law principles to deal mainly with income that originates in legal constructions, elaborate territorial source rules are not necessary and may even be beside the point.[64] But in accounting for why, at least historically, territorial source rules may have been underdeveloped, this may be an aspect.

Given that the Act preserves Canadian tax jurisdiction for all income of Canadian residents, including property income earned indirectly and essentially excluding business income from the tax base, the utility of complex territorial source rules is doubtful. Where the "innocence" of this approach may be tested through imprecision or avoidance, rules pertinent to territorial source have been adjusted, but not to introduce jurisdictional precision. Accordingly, for example, when the direct foreign tax credit regime proved to be vulnerable to derivative and hybrid transactions, refinements were introduced. However, those changes focused on whether "income" should be considered to have been earned according to the Canadian tax notion of income and whether the underlying transaction giving rise, allegedly, to creditable tax had, within the full compass of the relevant foreign law, given rise to foreign tax paid; the refinements were not territorially oriented.

The notion of territorial source is expressed through charging rules, income measurement rules, and a vast, ever-growing body of anti-avoidance rules to preserve the Canadian notion of source (such as transfer-pricing rules and FAPI rules). The closest to territorial source rules to be found in the Act are some deeming rules, such as section 253 and subsection 212(13). The Act largely defers to case law[65] and private law for establishing source. It could be said that income tax law is accessory to the private law that defines and gives life to persons, events, property, and activities, the realization of the value of which, as the case may be, is actionable under the tax law.[66]

"Source" Implied by Charging Rules or Computation Rules

The charging rules in parts I, XIII, and XIV provide some indication of what source means as a jurisdictional construct. These rules tend to merge notions of qualitative and territorial source in expressing the parameters of the Canadian tax base that focus on and try to describe, not prescribe, how income originates such that it is "Canada's income."

Subsection 2(3) imposes part I tax on a non-resident's income from employment in Canada, COBIC income, and income from the disposition of taxable

Canadian property. Section 4 provides that income shall be computed according to four qualitative sources—business, employment, property, and capital gains—with respect to each place for which there is a relevant focus. These qualitative and territorial source rules are elementary and not very meaningful in a tax system with a comprehensive worldwide base, at least insofar as basic income computation is concerned.[67]

Qualitative source is generally uncontroversial.[68] The computation rules apply in much the same manner to similarly situated non-residents with respect to income of like qualitative origin as long as that income has been earned in Canada, generally because the non-resident was somehow present in Canada in the same manner as a Canadian resident engaged in earning the same kind of income.[69] Until relatively recently, the capital gains base, composed with reference to "taxable Canadian property," was quite broad. It has shrunk recently to comprise property used in conducting Canadian business and other property that manifests an investment in Canadian real or immovable property (a piece of Canada) when Canadian residents can avoid capital gains tax by availing themselves of tax-free savings accounts and other tax-deferred savings vehicles.

The "location" of income (its territorial or geographic source) is separately addressed by section 4. Income from each qualitative source is meant to be determined with reference to the place or places where it is earned. This income tax accounting exercise is less daunting than it may seem, since there is not much need for being excessively concerned, at least at the margins, about the precise place.[70] There are, of course, potentially hard cases, particularly where the source of income is legally fictional, inanimate, or intangible. Indeed, much of the tax authorities' administrative guidance has been concerned with these cases.[71] More importantly, the qualitative source rules have systemic implications for determining the location of an income-earning activity, taking account of private-law considerations that necessarily enliven the meaning and scope of tax law. As noted above, the circumstances of employment in Canada, carrying on business in Canada, and the disposition of a piece of Canada indicate the Canadian origin of the income.

Part XIII of the Act broadens the tax base where a non-resident's property, rather than the non-resident person, is present in Canada and the income-earning potential of that property is unlocked largely through the use of that property by a Canadian resident. From the beginning, the withholding device did not mark a differential quality of income, but rather recognized the public-law limitations on enforcing revenue laws territorially. For example, leasing of property for use in Canada or receiving royalties from Canada was deemed by the 1924 IWTA to be carrying on business in Canada.[72] Part XIII withholding tax applies to payments of interest, rents, royalties, and dividends, irrespective of their qualification as income from business or income from property. The notion of Canadian origin is expressed in part XIII by reference to the Canadian residence of the payer, which uses the non-resident's property or the non-resident's COBIC income that bears the fiscal burden of the tax-deductible payments (for example, interest and rent).

Canadian Residence as a "Source" Proxy or Indicator

Canadian residence can be seen to be and used as a proxy for source in several ways. First, the Act establishes the scope of personal income tax jurisdiction on the basis of residence in Canada (subsection 2(1)). Income derived from elsewhere, especially income from capital, is presumed to originate in Canada. Second, the current Act defines jurisdictional parameters for non-residents in a manner that mirrors, in respect of the specified types of income (that is, income from employment in Canada, COBIC income, and capital gains from the disposition of a piece of Canada), how similarly situated residents would be taxed (subsection 2(3)). Third, the notion of Canadian origin expressed in parts I and XIII is the basis for establishing the foreign origin of income of Canadian residents. Canada expects the source determination in the foreign country to be similar to that under the Act in determining whether Canada should recognize the tax imposed by that country. In other words, the reciprocal expectations of the Canadian tax system help to establish the principles on which Canada will defer to the tax claims of other countries to which Canadian residents have established a connection similar to that contemplated for non-residents in relation to Canada. In effect, residence or the parameters that establish the meaning of residence may be seen to function as a proxy for source.

More specifically, as discussed above, income from elsewhere derived by Canadian residents is taxable in Canada. Because foreign business income earned through foreign intermediaries is, in effect, excluded from the Canadian tax base, Canadian residence is used as a proxy through its application to other types of income, especially income from capital. Income from capital owned by Canadian residents is taxable in Canada whether it is earned directly or indirectly through foreign intermediaries. This idea is preserved through the FAPI regime, which came into effect in 1976.[73] The regime was introduced to impute "foreign accrual property income" to the Canadian shareholder of a controlled foreign affiliate. In effect, it looked through the foreign intermediary for the purpose of taxing the Canadian-resident shareholder in respect of FAPI, which includes primarily income from capital.[74] There is no "natural" or intrinsic reason for such income not to be considered to be earned by the Canadian resident. A foreign legal fiction functions as an incorporated "pocketbook" or source-diversion device. In proposing the FAPI regime in 1969, Finance Minister E.J. Benson explained that "not all foreign corporations carry on bona fide business operations."[75]

For part XIII purposes, Canadian residence linked to the source of a non-resident's income is critical to the determination of whether that income is subject to tax. In the case of dividends, Canadian residence of the payer corporation is the sole factor. In the case of interest, rent, and royalties, Canadian residence of the payer is the main factor. Thus, the Canadian residence of the user of a non-resident's capital or property is the proxy for Canadian origin of the non-resident's income from such use.

Carrying On Business in Canada: An Important Particular Case

Carrying On Business in Canada as the Determinant of Canadian Origin

As discussed above, a non-resident who carries on business in Canada is subject to tax under the Act. The Act also determines the Canadian source of income that is derived from or connected with that activity. For example, when a non-resident corporation removes after-tax COBIC income earned through a branch, it is liable to a branch tax under section 219. When COBIC income is earned by a Canadian subsidiary of a foreign corporation, the distribution of after-tax income is subject to a dividend withholding tax under subsection 212(2). When payments of interest, rent, or royalties are deducted in computing COBIC income earned by a non-resident,[76] the origin of these payments is Canada for withholding tax purposes (subsection 212(13)). A substantial role of part XIII is to preserve the qualitative and locational character of income earned by non-residents. This is suggested by its origins in the 1924 version of what is now section 253. The non-resident withholding tax, as a tax collection mechanism, is a unique feature of the Act and was adopted for practical reasons.

More tellingly, the Act contains a variety of anti-avoidance measures to ensure that COBIC income is taxable in Canada irrespective of the legal arrangements or devices used to deflect such income out of the Canadian tax base. Many, if not most, of the anti-avoidance rules that are applicable to corporations are motivated by the need to protect the Canadian taxation of COBIC income at the corporate level (part I tax) and the shareholder level (withholding taxes). Examples are transfer-pricing rules, thin capitalization rules, surplus-stripping rules, and FAPI deeming rules that apply to certain payments traced to carrying on business in Canada. More pointedly, the function of such anti-avoidance measures is to preserve the Canadian tax base to the degree that is consistent with the origin of income regardless of the use of legal conventions, including those identified with more legalistic conceptions of source, to re-source income.

Transfer-Pricing Rules

Subsection 3(2) of the 1917 IWTA was the first source-preservation rule to deal with intercompany transactions. It read as follows:

> Where an incorporated company conducts its business, whether under agreement or otherwise, in such manner as either directly or indirectly to benefit its shareholders or any of them, or any persons directly or indirectly interested in such company, by selling its product or the goods and commodities in which it deals at less than the fair price which might be obtained therefor, the Minister may, for the purposes of this Act, determine the amount which shall be deemed to be the income of such company for the year, and in determining such amount the Minister shall have regard to the fair price which, but for any agreement, arrangement or understanding, might be or could have been obtained for such product, goods and commodities.

During the parliamentary debates on the introduction of the statute, Sir Wilfrid Laurier asked the finance minister if he could clarify the meaning of this provision by giving a concrete example of when it might apply. The minister, Sir Thomas White, replied:

> There might be an international case in which a company in the United States would own all the shares of a company in Canada. The Canadian company might be doing a highly profitable business if it was carrying on its affairs in the usual course, but by reason of a contract which it might have with the United States company to sell its product at a very low rate, it might show no profits at all. I may say this section is the same as the one in the Business Profits War Tax Act, inserted for the purpose of making such companies contribute reasonably under that measure of taxation.[77]

Subsection 3(2) applied to both resident and non-resident corporations carrying on business in Canada. Canada's taxation of COBIC income was protected through the minister's discretionary authority to adjust the taxpayer's income by denying deductions for the cost of goods purchased by, or rent or royalties paid to, a non-resident related company. According to one commentator, this provision was designed to prevent the evasion of tax by the sale of commodities to a parent, subsidiary, or associated corporation or partnership at a price below the fair market price.[78] Subsection 3(2) of the 1917 IWTA became section 23 of the 1924 IWTA,[79] which included the purchase of "any commodity from a parent, subsidiary or associated corporation at a price in excess of the fair market price." This provision later became section 23 of the 1939 IWTA, section 17 of the 1948 Act, subsection 69(2) of the 1972 Act, and section 247 of the 1998 Act.[80] Section 23B of the 1939 IWTA provided a similar rule:

> Where any person carrying on business in Canada pays to a non-resident as price, rental, royalty or other payment for the use of any property or reproduction thereof, or for any right, an amount which is not in conformity with similar payments made by other persons in the same kind of business, then such payment may, for the purpose of determining the income of such person, be adjusted by the Minister accordingly, unless he is satisfied that the payor and the recipient are not associated, controlled one by the other, or controlled by the same interests.

These rules protect the Canadian taxation of COBIC income by policing the price of self-dealings, because if such price were respected, COBIC income would be artificially reduced by underinclusion in revenues or overdeduction of expenses. This can be seen from the following exchange in Parliament in 1924:

> Sir Henry Drayton: I suppose the effect of this is to prevent associated or holding companies making fictitious expenses a vehicle for evading the Income Tax Act? . . . Have I not got the idea right?
>
> Mr. Robb: My hon. Friend is correct.[81]

Thin Capitalization

A thin capitalization rule is now found in subsection 18(4) of the Act. It was originally enacted in 1972[82] to prevent diversion of income from carrying on business in Canada through the use of a corporate legal fiction and the legal flexibility of capitalization by debt or equity. In proposing this rule, in 1969, Finance Minister Benson offered the following rationale:

> The Canadian tax system contemplates that non-residents who earn business profits in Canada shall pay income tax to Canada at the rates that apply to Canadians. . . . If a foreign corporation carries on business here, it is taxed on the profits at the corporate rate of 50 per cent. If the foreign corporation incorporates a Canadian subsidiary, the Canadian corporation is taxed on the profits at 50 per cent, provided the foreign corporation makes its investment in the form of shares. If, however, the foreign corporation makes part of its investment as a loan, the interest on that loan is a deduction in computing business profits. It therefore saves tax at 50 per cent, but it bears Canadian tax only at the withholding rate of 15 per cent (or 25 per cent if not protected by treaty). It is a natural thing for corporations to borrow, and not unnatural for them to borrow from their shareholders, but the difference in tax rates has tempted some to create corporations with very nominal share capital (say $3) and to make virtually all of their investment as an interest-bearing loan.[83]

Canada's tax jurisdiction is based on the fact that the income originates from carrying on business in Canada. The Act recognizes the "natural" use of debt financing by corporations but draws a line when the borrowing becomes "unnatural." The original line was a 3:1 ratio of shareholder debt to equity. This ratio has been changed over the years and is currently 1.5:1.

Surplus Stripping

Corporate income earned by a non-resident carrying on business in Canada is, by design, taxable to the corporation and the non-resident shareholder. The shareholder-level taxation takes the form of dividend withholding tax or tax on capital gains from the disposition of shares. Where a non-resident corporation earns COBIC income directly through a branch, the branch profit tax functions as a proxy for the dividend withholding tax.

From the beginning, the drafters of the IWTA were alert to possible distortions of the tax base by the effective re-sourcing of COBIC income on the basis of ownership, the quality of the income, or the place of realization. Re-sourcing inevitably would arise from the separation of income from its owners, the recognition of the fiscal significance of corporations, and the failure to tax gains reflective of undistributed corporate earnings that had not otherwise (as the original IWTA had provided) been taxed at the shareholder level whether distributed or not. The surplus-stripping rules seek to prevent the dissipation of taxable income that originates in Canada and should be within the tax base..

As early as 1934, section 23A of the IWTA (which is the origin of current subsection 17(1)) provided:

> Wherever a Canadian company advances or has advanced moneys to a non-resident company and such advances remain outstanding for a period of one year without any interest or a reasonable rate of interest having been paid or credited to the Canadian company, the Minister may for the purposes of this Act, determine the amount of interest on such moneys which shall be deemed to have been received as income by the Canadian company.[84]

The Canadian company presumably would have accumulated the capital from after-tax profits from businesses carried on in Canada. Canada is thus the source of both the capital and the income from the capital. When such capital is advanced "free of charge" to a non-resident company, thus depriving Canada of the taxation of interest that should have been earned, section 23A denies that tax consequence.[85]

As corporate-level and personal tax rates began to diverge, the ingenuity by which the character of income was transformed, and in the result was exiled from the tax base, increased. A series of legislative reactions directed at recapturing lost shareholder-level business tax seemingly had limited salutary effects. In significant part, the persistent Canadian tax policy concern with surplus stripping in this context motivated the Carter commission to recommend taxing capital gains.[86] The Act now contains the following anti-surplus-stripping rules:

- expansion of the notion of "dividend" for part XIII purposes (subsections 15(1), 214(3), and 212(2)), allowing interest on participating debt to be treated, in effect, as a dividend;
- provisions applying to constructive dividends through capital appropriation (subsections 15(2) and 214(3), and section 80.4);
- preferred offshore financing provisions (appropriation of capital) (section 17);
- provisions to deter excessive interest deductions and resulting shareholder appropriations (subsections 18(4) through (8)); and

- provisions dealing with indirect realization and character transformation of underlying corporate value (capital gains strips) (subsection 55(2) and sections 212.1 and 212.2).

Indeed, the recently enacted section 212.3 (the foreign affiliate dumping rules) encapsulates the law's historical concern with distortions that, in our terms, can be described as "source" distortions—that is, arrangements that separate income from its Canadian origin without the occurrence of any transformative event that would have the same effect. The explanatory notes accompanying the introduction of this provision state:

> [T]hese rules are designed to deter Canadian subsidiaries of foreign-based multinational groups from making investments in non-resident corporations that are, or become . . . , foreign affiliates of the Canadian subsidiary in situations where those investments can result in the inappropriate erosion of the Canadian tax base. The erosion can arise because of the exempt treatment of most dividends from these foreign affiliates in combination with the interest deductions on debt incurred to make such investments (Part I tax base) or the ability to extract corporate surplus from Canada free of dividend withholding tax (affecting directly the Part XIII tax base and, indirectly through the diminution of income-earning capacity in Canada, the Part I tax base).[87]

A very recent example of this continuing concern to preserve the origin of Canadian income, which involves the taxation of the net income of Canadian-resident corporations and the related "income" of non-residents who receive deductible payments from Canadian residents, is the increasing refinement of the rules that deal with various back-to-back arrangements.[88] These arrangements have the effect of suppressing withholding tax that otherwise might be exigible on payments made by Canadian residents that reduce the Canadian tax base and that originate in, or have their natural connection to, Canada. The withholding tax rates, as modified by tax treaties, may be seen as a rough justice approximation of the part I tax rates that would generally apply if non-resident recipients of amounts paid by Canadian residents were taxable as residents in similar circumstances. In other words, the affected arrangements might operate simply by redirecting flows through intermediaries to obtain felicitous treaty rates. Or the more sophisticated among them might introduce an element of hybridity or character transformation, starting out as one form of payment and emerging as another.

The back-to-back rules operate on the expectation that taxable income that originates in Canada would not be diverted or its character would not be changed in a manner that results in an undue reduction in recipient-level tax. Another way to perceive this is that the art, or artifice, of legal constructions should not have such a transformative effect that the origin or source of income is made to appear to be other than what foundationally it is.

FAPI and Deflected COBIC Income

The FAPI regime has for some time included a variety of base erosion brakes, notably in paragraphs 95(2)(a.1) through (a.4), 95(2)(b), and other supporting provisions. These rules essentially preserve the Canadian taxation of income originating in Canada by including the "deflected" amounts of payments in income as FAPI. The Canadian origin of these deflected payments is generally COBIC income of a Canadian-resident or non-resident corporation because the payments are deductible in computing the corporation's income. In circumstances where no adverse interests limit the extent to which the use of cross-border legal constructions may re-source income, the FAPI rules effectively preserve the Canadian origin of that income, and consequently the Canadian tax base.

Conceptualization of Source

Source as a Legal Construct

Source is a legal construct for the purposes of the Act. This is the case in spite of how the debate about its meaning and significance has been joined in the literature,[89] and in spite of the complexity of source-oriented "rules" in the legislation of some countries (such as the United States). Ultimately and, we would say, hardly surprisingly, establishing the "source" of income involves identifying where that income may be considered to have originated—where it was "earned" and, in that connection, whether it has any "real and substantial link" with a country so as to justify that country's assertion of tax jurisdiction or, correspondingly, renunciation of an otherwise sustainable sovereign tax claim in favour of another country.

Since the function of source is to define the basis or limits of Canada's tax jurisdiction, this determination engages an evidentiary analysis of what actually happened in the income-earning process. That analysis is, of course, adjunct to a legal analysis of where income is earned, which equally takes account of the legal obligations and rights of parties to the events giving rise to the income according to a legal substance analysis. The means by which income was earned essentially establishes where it came from qualitatively and territorially. Certainly, there are cases where, despite general agreement on this point, more precise indicators have been required. These cases are drawn from the private law. Where the dispute involved a conflict over classification or qualification, the conflict was resolved according to conflict-of-law principles and, to some degree, by reference to the terms of tax treaties, though even conflict of laws and tax treaties unhelpfully presume to know where income "arises" without actually establishing a code or measure for making that determination. In practice, great reliance has been placed on the residence and the locational presence of recipients of taxable amounts of income. In the meantime, "legal formalism" is countered by anti-avoidance rules in order to buttress the Canadian notion of source.

Particularly noteworthy are amendments to the direct foreign tax credit regime to deal with abusive tax planning. Interestingly, the focus of these amendments has not been so much on the locational origin of the income, but on how income is measured, taking into account relevant Canadian tax considerations under the Act. New subsections 126(4.1) and (4.2) incorporate economic tests of income and limitations on the creditability of foreign tax arising from short-term securities transactions. They are not merely mechanical or computational rules, though this is their immediate effect. Rather, they are in the nature of ulterior source rules. They are designed to detect and measure whether a Canadian taxpayer is able to establish a sufficient connection to revenue originating elsewhere that may warrant Canada's essentially funding the foreign tax incurred by the Canadian taxpayer.

Of even more far-reaching import in this regard, and possibly indicative of why the Canadian tax system is concerned with locational measures of income or, perhaps more accurately, its origin, was the legislative response to so-called foreign tax credit generator transactions. In light of earlier observations about source having legal rather than economic ramifications for tax purposes, which, pointedly, are jurisdictional as much as they are computational, there are some lessons in this legislative experience. Foreign tax credit generator transactions essentially generated a measure of foreign tax according to general Canadian tax-law and private-law determinations, but the tax was not in fact paid to the foreign treasury because of the effect of that country's tax-law and private-law determinations. In those cases, there was little doubt that the "activity" (such as it might be) and the legal features of the participants in the transaction could be said to determine where the income was purported to originate. But the locational question was, essentially, almost beside the point. The real question was whether Canada should fund the payment of—really, whether Canada should pay—the tax that, according to where the income and putative tax liability originated, was actually collected by the "root" foreign treasury, taking account of all relevant circumstances that, by their design, were meant to be considered and to function seamlessly as a whole. Interestingly, and consistent with how Canada has conceived of tax jurisdiction since the original enactment of the IWTA, the Canadian legislative response was intrinsically "legal"; it was to measure Canadian foreign tax creditability of foreign income according to all the legal elements of the foreign arrangements, under both tax law and private law—essentially, to incorporate by reference the foreign legal environment to which the tax that Canada was asked to credit was said to be attributable.

The striking implication of the Canadian legislative response to foreign tax credit generators was to accept, and then statutorily embed in the machinery of the Act, the transactional origin of the income as a legal matter, and then to ask (and answer) the jurisdictional question of why Canada would cede its tax jurisdiction on the basis of where the income originated. In effect, as may be said more generally, the Act is essentially concerned with the origin of income earned by Canadian taxpayers (or would-be Canadian taxpayers in the case of non-residents' "inbound" income-earning activities); accordingly, "source" is more a descriptor of the legal features and consequences of origin once established. However, the Act does not have prescriptive rules of origin. The Act more or less assumes origin on the basis of objective evidentiary indicators of the origin of income, coupled with legal conclusions concerning how economic actors behave when originating income.

The Act relies on private law and conflict-of-law principles for establishing the circumstances—the relationships, the organizational forms, the personalities—to which the tax law applies. In some cases, this may involve reliance on the legal connotations of "place" or origin established, for example, by the law pertinent to determining whether certain kinds of claims exist as independent property and then how they are activated (that is, performed). Typically, we would not think of legal conventions in the same way as tangible property. And yet the locational connections of property in law exude the same considerations from a tax jurisdiction perspective. Such considerations may indeed underlie the Canada Revenue Agency's historical practice for sourcing income. In the case of income from property, for example, is the source of income arising from an obligation or a user arrangement? Where is property acquired through the implementation of legal steps? Where are legal obligations considered to be performed and legal rights exercised? Leaving aside the fact that decisions of this kind sometimes require human intervention, the question still remains: What is the origin of income, and how can the fiscal notion of source capture it? In these circumstances, even where the Act reflects the assumption that the source of income is where obligations are performed and rights are exercised, the foundational consideration is where income originates. The determinants of the origin of income take account of functional and legal considerations that seek to detect where relevant operations, relations, and such actually occur, even if they are separated from their progenitors.

It is axiomatic that tax law is accessory to the private law—the law of property, contract, business organization, intellectual property, and so on. It is the private law that establishes the parameters of relationships, property ownership, and property use. The tax law latches onto these determinations for its own purposes, occasionally introducing bespoke fiscal qualifications where, it must be thought, the private law is insufficient to establish or protect the requisite tax base. But, artfully, the manner in which Canadian tax jurisdiction has been established or how the origin of income has been determined according to how it is earned has dominated the scope of Canadian taxation, and indeed has been influenced by "residence" considerations of proximity to justify taxation. To a large degree, legal determinations of source have been eclipsed by functional determinations of how and where the events giving rise to income actually take place, or perhaps—as some of the OECD's analysis in the BEPS context seems to suggest—where those events, and consequently the origin of income, cannot be found.

The Canadian Approach to Source in the Past 100 Years

Our review of the Canadian approach to establishing source, as it has evolved since 1917, reveals a number of themes and tendencies. As we noted in the introduction, that approach may be described as systemically simple, but it is neither simplistic nor, in tax policy terms, naïve or too forgiving.

The Canadian approach is jurisdictional and for the most part reflects observable circumstances that do not require "rules" to establish jurisdictional association. The IWTA and the Act seem to have avoided excessive reliance on rule-based determinations of where income originates, adopting instead descriptions of the kind of property or the actual location of activities that necessarily reflect a Canadian presence of some kind and therefore a Canadian origin of income, or alternatively, but according to the same principles, establish that the origin is not Canadian and therefore Canada should give way. The approach is framed by qualitative source rules that reflect what loosely might be described as "natural associations" of income to what, in more legalistic terms, would be called its "source." The emphasis has been to describe those associations rather than to prescribe them, even though the jurisdictional outcomes seem to be consistent with competing theories about the meaning of "source" as a jurisdictional parameter or with international tax norms.

The Canadian approach is internally consistent with how the "Canadianness" of income and the "non-Canadianness" of income is established. The way in which Canada exercises its tax sovereignty and anticipates the exercise of tax sovereignty by other countries is consistent with international tax norms and paradigms in tax treaties. Despite an urge, possibly with historical conviction, to characterize treaties as being dominated by residence taxation, in fact they allow the source country a primary right to tax if it is able to demonstrate a measurable and sustained connection to how business income is earned, and they expect the residence country to give way by credit or exemption. Equally, the distribution rules for dividends, interest, and royalties (and other kinds of income) favour the residence country but intrinsically acknowledge that the source country may maintain a degree of taxation. In effect, these treaty rules recognize how a non-resident may be present in a source country in the form of its property; this is more clearly an "active business income" analogue for royalties. (In the Canadian context, it is evidenced by the origin of paragraph 212(1)(d) traced to the deemed carrying on business in Canada rule in 1924.)[90]

The Canadian approach to source is legally principled and contextually practical. It is not simplistic, nor does it conflate important legal principles with practical realities. It is, however, for the most part quite simple. It derives its principles and effect from observations about how income is actually earned, notably where effort or capital is actually deployed in ways that can generate income. The focus for the most part is on income-earning activities, not legal badges of presence and entitlement. Rules, conventions, principles, and practices conceived as "territorial source rules" are more accurately expressed as jurisdictional statements in the Act or tax treaties about the scope of Canadian taxation based on empirical linkages or "real and substantial links" of taxpayers and income to Canada. In principle, business income is primarily and maybe even exclusively taxable according to its source—where production activities occur particularly. Non-business income (income from property) is mainly taxable where the taxpayer resides but not without some measure of source-country tax that recognizes the limited presence of the taxpayer, by way of its property, in the source country where the monetary value of that property is, or may be, unlocked to create income for the taxpayer. In other words, non-business income is taxed where the taxpayer resides and where property is actually used, regardless of other conditions affecting the tax personality of its owner. An exception may be claims of various kinds that have a life separate from how they are funded and therefore have a functional as well as a legal location that is established by the personality of the claim, possibly, rather than the location of the person obliged to perform it.

Under the Canadian approach, the source of income is seen as a measure of an objectively justifiable and practical assertion of tax jurisdiction. Taxation is about the practical ability of sovereign states to exact a measure of return on their "co-investment" in the activities of taxpayers. States can be viewed as economic actors themselves, and in a manner of speaking, co-venturers of taxpayers in the income-earning activities. The extent of such co-investment by a sovereign state justifies its assertion of taxing rights against those of other countries. In the case of Canadian residents, Canada provides the opportunities for accumulating capital and for earning income from business, investment, and services. In the case of non-residents, Canada provides the natural and legal environment for carrying on business activities in Canada.

In effect, Canada does what many other countries do, defining the scope of its tax jurisdiction by asserting it according to its own standards. At the same time, Canada limits the otherwise unlimited scope of tax claims through reciprocal arrangements with other countries or unilaterally, taking into account inter-nation fiscal equity and Canada's economic interests. Canada is expected to mobilize its resources and invite capital investment in order to generate a return from the economic endeavour of taxpayers sufficient to fund Canadian social welfare choices, exacting a charge for the rent associated with the use by taxpayers of public resources.

Challenges Ahead

The utility of the current notion of source that frames and illuminates Canada's assertion of jurisdiction to tax is perceived to be vulnerable because of the ability to earn income from "everywhere and nowhere" at the same time. Taxpayers can conduct business or engage in other activities by being "present" personally or via property in Canada without the sorts of connections or associations described in the Act. Indeed, the legal conventions that the Act seemingly has navigated in order to express the notion of source have not been very contentious, allowing not only for the separation of income from owners but also owners from the "places" where, otherwise, income might be considered to originate. Using anti-avoidance rules as negative source rules has its limitations.

Jurisdictional connections taken for granted as a matter of necessary course by "source" concepts, as such or as manifested in jurisdictional notions such as carrying on business in Canada or permanent establishment, may be unreliable. For example, the Canadian market can be exploited by non-resident online vendors without having an agent engaged in solicitation in Canada, at least in the ways that section 253 of the Act and article 5 of most of Canada's tax treaties would suggest is necessary as a primary determinant of Canada's possible jurisdiction to tax. Globalization and digitization have also distorted the usual expectations for the private law on which tax law depends, even for tax regimes such as Canada's that navigate limitations inherent in the determination of tax jurisdiction with reference to narrow legal notions. Indeed, as we noted earlier, to the extent that legal determinations connected to the enforceability of obligations and the exercise of rights determine source where tangible elements are not present, it may be that even the private law and conflict-of-law principles are inadequate.

The vulnerability may also lie not in the absence of connections and associations consistent with how Canada has conceived of source in terms of the origin of income, but in Canada's ability to enforce tax claims when most elements and personalities, except perhaps consumers, are not in any sense, other than a virtual one, present in Canada. Notably, to the extent that income is somehow attributable to financial transfers or to the development and mobilization of the value of intangibles of various kinds, the current approach may be inadequate. It is this sort of concern, masked as transfer pricing, that animates the continuing work on BEPS concerning intangibles, risk, and other elements of what frequently is a transfer-pricing analysis of how (qualitative source) and where (territorial source) income of multinational enterprises not only should be considered to be earned but according to prevailing law and related evidence-based analysis was earned—that is, has its source.

A continuing challenge is to how to identify and determine the fiscal significance of legal entities and arrangements used by taxpayers to locate income at the places that cannot in any transformative sense be said to be functionally or financially responsible for generating the income. Indeed, the fiscal significance of intermediation, notably corporate intermediation, has been a persistent concern in the evolution of the Canadian tax system from its first modern federal expression in the IWTA.[91] It may also lie at the core of the BEPS project despite the multiplicity of specific actions, concerned as most of the actions are, in one way or another, with avoiding distortions in how and where income is considered to be earned—that is, its source—attributable to legal artistry and/or indefinite jurisdictional connections of intangibles and financial property.[92] Anti-avoidance rules can, and in important respects do, function as negative source rules; essentially, they may provide that legal construction itself is not enough to establish source. Examples are the recent rules giving legislative expression to longstanding

concerns with back-to-back and character transformation arrangements that effectively neuter a portion of the tax base that is funded by the Canadian operations or presence of somebody, and thus necessarily originates in Canada. In the absence of a clear articulation of what source means, however, the collective body of anti-avoidance rules cannot adequately express what is not the source.

Is It Time for (Clear) Prescription?

Are the latent challenges noted above creating a need for more precise sourcing of income? The answer is possibly "yes," even in the business-income-tax context. Historically, Canada has essentially asserted taxation of business income of Canadian origin measured through traditional and usually physical connections (for example, productive or marketing activities in Canada or sale of Canadian real or resource properties). Canada has relinquished the taxation of business income with a foreign origin measured through similar physical connections. What happens when the entire metamorphosis of a commercial transaction has, and needs to have, no more of a connection than Canadian customers? This is the case with business conducted digitally, including the provision of access to digital products.

In the context of income from the use of property, the need for a clear prescription is more evident. What happens when it becomes difficult to establish the origin of income because the income in question reflects returns on property interests that have no natural connection to Canada or elsewhere? The lack of natural connections to a place puts emphasis on the use of legal constructions to locate income from property. As early as 1917, the legislators sought to avoid the diversion of Canadian taxpayers' income from the Canadian income tax base through legal constructions. Much attention was paid in the parliamentary debates on the IWTA to the fiscal perils of holding companies and uneconomic transfers between related parties. These issues persist, and even dominate, 100 years later. The possibility to navigate territorial source with legal artistry has in fact dominated the BEPS project. But the solutions from the BEPS project may not be good enough for Canada.

Without purporting to develop or assert affirmative source rules, essentially the direction of much of the OECD's BEPS work is to use legal analysis, attuned to the principles underlying tax jurisdiction and informed by the legal expectations associated with legal constructions, to determine what is not the source—mostly the territorial but also more generally the legal and even the qualitative source—of income. The OECD chose not to lift a corporate veil or abandon the arm's-length standard. Instead, the final analysis incorporated in the BEPS project's treatment of transfer pricing according to actions 8, 9, and 10 seemingly recognizes and relies on the significance of evidence-based "legal substance," despite the persistent influence in transfer pricing of "economic substance," and in that regard the importance of being able to find autonomous functional and financial capability and significance in legal intermediaries to which meaningful profit would be attributed. Limitations on the entitlement of non-functional intermediaries—those that do not engage and indeed do not have the financial or functional capacity to engage in transformative activities—nevertheless to share generously in income earned by multinational enterprises amount to negative source rules.[93]

The signposts offered by traditional markers of source are easily navigated by taxpayers. Even with the development of the permanent establishment, treaty abuse, and transfer-pricing concepts in the BEPS reports, the notions influencing how and where income originates are still largely formal and historical, and deferential to legal form, notably contracts and corporations. The negative sources may not be adequate. A positive expression of source anchored in the co-venture idea is arguably a better approach. The ways in which Canada contributes to the income-earning venture are different now than they were 100 years ago. However, even though the income-earning process today is more fragmented and less physical, arguably the Canadian notion of source remains viable. It is perhaps time for Canada to express this notion through more affirmative rules. Canada has recently discussed a sort of enlightened view of existing jurisdictional norms in the minister of national revenue's e-commerce report.[94] It is certainly possible to embark on a process of renewing, recalibrating, and applying in a "century-later" way the underlying, indeed continuously underlying, principled approach of Canadian income tax law to the territorial source of income.

Notes

1 The Income War Tax Act, 1917, SC 1917, c. 28. In this paper, "IWTA" without reference to the year of enactment is used to refer collectively to versions of the statute in effect before the change of name to "the Income Tax Act" in 1948.

2 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act" or "the current Act"). In this paper, "the Act" is also used to refer collectively to versions of the statute in effect between 1948 and 2016. Unless otherwise stated, references to specific provisions are to provisions of the current Act.

3 See Bret Wells and Cym H. Lowell, "Income Tax Treaty Policy in the 21st Century: Residence vs. Source" (2013-2014) 5:1 *Columbia Journal of Tax Law* 1-39; Richard M. Bird and J. Scott Wilkie, "Source- vs. Residence-Based Taxation in the European Union: The Wrong Question?" in Sijbren Cnossen, ed., *Taxing Capital Income in the European Union—Issues and Options for Reform* (New York: Oxford University Press, 2000), 78-109; Mitchell B. Carroll, *Taxation of Foreign and National Enterprises*, vol. 4, *Methods of Allocating Taxable Income*, League of Nations doc. C.425(b).M.217(b).1933.II.A (Geneva: League of Nations, 1933); and Mitchell B. Carroll, *Prevention of International Double Taxation and Fiscal Evasion: Two Decades of Progress Under the League of Nations* (Geneva: League of Nations, 1939). There is considerable room for debate about the intended scope of "source" and "residence" taxation within this paradigm and, for that matter, about the utility of these notions to assist in the allocation of "international income," particularly business income, among contending nation claimants, presumably on the basis of some measure of functional or other connection of taxpayers and/or the income-earning process to those nations. Wells and Lowell, supra, observe that work undertaken by the League of Nations, as given voice by Mitchell Carroll, can be read and interpreted as reflecting fairly severe limitations on the taxing rights of a source state, with the residual income gravitating to the tax base of the residence state (an approach that, as they note, contrasts with early recommendations preceding the League's work made by the International Chamber of Commerce). Their observation is particularly interesting in light of the continuing transfer-pricing debate about how profits should be split, notably profits that are associated with the origination and deployment of "intangibles" within a corporate group as well as synergistic benefit or group association.

4 See, for example, subsections 250(1) and (4). The notion of residence reflects longstanding jurisdictional connections and undercurrents associated with residence on which the tax law could be said to rest. Further, the Act embroiders and hardens that notion so as to insist on certain residential connections that might otherwise be less obvious or less easily sustained absent legislative specification and even a bright-line determinant.

5 In contrast to the foreign tax credit rules in the United States: Internal Revenue Code of 1986, as amended, part I ("Source Rules and Other General Rules Relating to Foreign Income"), sections 861 through 865.

6 Canada, Royal Commission on Taxation, *Report of the Royal Commission on Taxation*, vol. 4 (Ottawa: Queen's Printer, 1966), part D. The report suggested that a sale of Canadian real property should be deemed to be a business carried on in Canada. It was silent on the notion of source. One commentator remarked, "It was perhaps unfortunate that the Commission did not take the opportunity to recommend definitions of 'residence' and 'source.' Much uncertainty surrounds these words in many countries, and particularly in Canada. Canadian case law is incomplete in many areas and some reliance is placed on British jurisprudence for interpretation of unsettled parts of Canadian tax law. Canada appears to recognize British rules of residence and source, but actually recognizes United States' rules in matters affecting U.S. taxpayers. The resultant uncertainty, and the probability that different rules apply to different countries, could have been recognized by firm recommendations." C.P.F. Baillie, *International Taxation and the Carter Report* (Don Mills, ON: CCH Canadian, 1967), at 56.

7 Canada, Department of Finance, *Report of the Technical Committee on Business Taxation* (Ottawa: Department of Finance, April 1998).

8 Canada, *Electronic Commerce and Canada's Tax Administration: A Report to the Minister of National Revenue from the Minister's Advisory Committee on Electronic Commerce* (Ottawa: Revenue Canada, April 1998).

9 Advisory Panel on Canada's System of International Taxation, *Final Report: Enhancing Canada's International Tax Advantage* (Ottawa: Department of Finance, December 2008).

10 For more general discussions of factors bearing on source and its relevance for tax systems, see Brian J. Arnold, "The Canadian International Tax System: Review and Reform" (1995) 43:5 *Canadian Tax Journal* 1792-1818; Brian J. Arnold and Jacques Sasseville, "Source Rules for Taxing Business Profits Under Tax Treaties," in Brian J. Arnold, Jacques Sasseville, and Eric M. Zolt, eds., *The Taxation of Business Profits Under Tax Treaties* (Toronto: Canadian Tax Foundation, 2003), 109-31; Brian J. Arnold, Jacques Sasseville, and Eric M. Zolt, "Symposium: Summary of the Proceedings of an Invitational Seminar on the Taxation of Business Profits Under Tax Treaties" (2002) 50:6 *Canadian Tax Journal* 1979-2024; Gérard Coulombe, "Canada's New Tax Treaties: Certain Policy Aspects of Canadian Tax Treaties," in *Report of Proceedings of the Twenty-Eighth Tax Conference*, 1976 Conference Report (Toronto: Canadian Tax Foundation, 1977), 290-303; Robert Couzin, "International Taxation—Current: The Foreign Tax Credit," ibid., 69-103; Jinyan Li, "Rethinking Canada's Source Rules in the Age of Electronic Commerce: Part 2" (1999) 47:6 *Canadian Tax Journal* 1411-78; Nick Pantaleo and J. Scott Wilkie, "Taxing Foreign Business Income," in *Business Tax Reform*, 1998 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1998), 8:1-44; Richard G. Tremblay, "Foreign Tax Credit Planning," in *Tax Planning for Canada-US and International Transactions*, 1993 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1994), 3:1-53; and J. Scott Wilkie, Robert Raizenne, Heather I. Kerr, and Angelo Nikolakakis, "The Foreign Affiliate System in View and Review," ibid., 2:1-72.

11 For example, Sir Thomas White (the finance minister who sponsored the 1917 IWTA) and Sir Wilfrid Laurier (the leader of the Opposition) sparred about the economic and fiscal significance of particular provisions of the IWTA, among other things foreshadowing the modern transfer-pricing industry in a point-counterpoint discussion that was as illuminating of the subject as any contemporary writing today.

12 This concept, which we have borrowed from public international law, was adopted by Rossiter J in his reasons for the decision in *Oroville Reman & Reload Inc. v. Canada*, 2016 TCC 75, at paragraphs 38-42. Recognizing the pre-eminent jurisdictional role and force of source, the notion of linkage is not only indicative of how jurisdiction and primary competing jurisdiction to tax are established, but also descriptive of the legal and evidence-based factual or functional forces at play in making a principled source determination and judgments about whether and to what degree source rules may need to be prescriptive, as well as how they should be expressed legislatively. See Ault and Bradford, infra note 16; and Kane, ibid.

13 For a list of BEPS reports prepared by the OECD, see www.oecd.org/ctp/beps-2015-final-reports.htm.

14 See J. Scott Wilkie, "Transfer Pricing Aspects of Intangibles: The License Model," in Michael Lang, Alfred Storck, and Raffaele Petruzzi, eds., *Transfer Pricing in a Post-BEPS World* (Alphen aan den Rijn, the Netherlands: Wolters Kluwer, 2016), 61.

15 Ibid. Also see J. Scott Wilkie, "An International Fiscal Revolution in the Making? Some Musings on Tax Policy and Its Economic Foundations," University of Calgary School of Public Policy Blog, September 26, 2013 (www.policyschool.ca/?s=%22international+fiscal+revolution+in+the+making%22); and J. Scott Wilkie, "Reflections on 'BEPS': Tax, Law and 'Law and Economics,'" University of Calgary School of Public Policy Blog, July 31, 2014 (www.policyschool.ca/reflections-beps-tax-law-and-law-and-economics/).

16 For example, the US source rules are the subject of some scholarly debates, including Hugh J. Ault and David P. Bradford, "Taxing International Income: An Analysis of the U.S. System and Its Economic Premises," in Assaf Raxin and Joel Slemrod, eds., *Taxation in the Global Economy* (Chicago: University of Chicago Press, 1990), 11-52; Michael J. Graetz, "Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies" (2001) 54 *Tax Law Review* 261-336; Robert A. Green, "The Future of Source-Based Taxation of the Income of Multinational Enterprises" (1993) 79:1 *Cornell Law Review* 18-86; Mitchell A. Kane, "A Defense of Source Rules in International Taxation" (2015) 32:2 *Yale Journal on Regulation* 311-61; Lawrence Lokken, "The Sources of Income from International Uses and Dispositions of Intellectual Property" (1981) 36:3 *Tax Law Review* 233-339; John Mutti and Harry Grubert, "The Significance of International Tax Rules for Sourcing Income: The Relationship Between Income Taxes and Trade Taxes," in Robert E. Baldwin, Robert E. Lipsey, and J. David Richardson, eds., *Geography and Ownership as Bases for Economic Accounting* (Chicago: University of Chicago Press, 1998), 285-310; International Fiscal Association, *Rules for Determining Income and Expenses as Domestic or Foreign*, Cahiers de droit fiscal international vol. 65b (Boston: Kluwer Law and Taxation, 1980); and Stephen E. Shay, J. Clifton Fleming Jr., and Robert J. Peroni, "'What's Source Got To Do With It?' Source Rules and U.S. International Taxation" (2003) 56:1 *Tax Law Review* 81-155.

17 See Malcolm Gammie, "The Relationship of Situs and Source Rules for Tax Purposes," in John Tiley, ed., *Studies in the History of Tax Law*, vol. 6 (Oxford: Hart Publishing, 2013), 81-134. However, as Gammie notes, there does not appear to be a close relationship between source as an income tax notion and the situs of property as it would be determined for the purposes of other legal regimes. Gammie says (ibid., at 133), having examined situs law and source in the context of UK and relevant international law, "Two points can be made in concluding. First, the cases illustrate that for income tax purposes the analysis has two stages: to identify the source of the income and then, where needed, to determine whether the source is a UK source or a foreign possession. The majority of cases have presented little difficulty in determining the source and, in this respect, the distinction that I have previously drawn between property and activities that are 'income producing' and 'participatory' rights in such income comes into play. The more difficult aspect has been to identify the criteria by which to determine, where relevant, whether the source is a UK source or a foreign possession. What seems clear is that the *situs* rules of international law have played no real role in the matter. A more significant contributor has been the concept of 'participatory' rights and the need to look through to the underlying property, activity or fund that is charged to tax as a means of determining whether income is UK or foreign."

18 *Oroville*, supra note 12.

19 Ibid.

20 According to this paradigm, the country of a taxpayer's residence enjoys the primary and residual entitlement to tax income earned by the taxpayer, however and from wherever it arises and regardless of the form in which it is delivered, subject only to suitable recognition of parallel tax claims made by the country where the income is considered to arise—that is, its source. The primacy of the residence country's tax claim could be matched and, via treaties emerging from the League of Nations' work, displaced by taxing rights of the source country if and to the extent that a non-resident of the source country was present in that country and acted to earn income there in a manner akin to the way in which a similarly situated resident of that country would earn income. The source country's entitlement and, as has been commonly manifest in tax treaties, its primary entitlement to tax can be explained in various ways with reference to notions of allegiance and the like; in sum, however, the source country is where the income is considered (and, when this paradigm was evolving, fairly reliably could be observed) to originate. Where the non-resident's presence in the source country was not personal and directly active, but arose from the use by residents of that country of property belonging to the non-resident, still for similar reasons the source country could justify a claim to tax income therefrom (just as readily as it would, again, for a similarly situated resident) as income from the use of the property or, as the history of the IWTA reflects, as a proxy for business income earned through the extension of the non-resident's business by the activities of a resident user of the non-resident's property.

21 These rules are discussed later in this paper under the heading "Legislative Expressions of Source."

22 Income War Tax Act, SC 1927, c. 97 (herein referred to as "the 1927 IWTA").

23 It is interesting to speculate whether the shipping exemption, including the present form of the provision in paragraph 81(1)(c), reflects a response to the same kinds of concerns affecting how to apply typical income tax notions to digital businesses—that is, conventional businesses conducted digitally—or the trade in digital products and services.

24 In practice, foreign taxes were allowed as deductions in determining the taxpayer's taxable income. See Colin Campbell and Robert Raizenne, "The 1917 Income War Tax Act: Origins and Enactment," 2:1-96, elsewhere in this volume.

25 1917 IWTA, subsection 3(2). For further discussion, see Campbell and Raizenne, supra note 24.

26 Income War Tax Act, SC 1939. c. 46 (herein referred to as "the 1939 IWTA"), section 9B.

27 SC 1970-71-72, c. 63 (herein referred to as "the 1972 Act"), amending the Income Tax Act, RSC 1952, c. 148, as amended (herein referred to as "the 1952 Act").

28 See Campbell and Raizenne, supra note 24. See also J. Scott Wilkie, "Three Spirits of Canadian Corporate Income Tax: The Relic, the Remnant, and the Reflection," 8:1-32, elsewhere in this volume, and Couzin, supra note 10.

29 Campbell and Raizenne, supra note 24.

30 Underwood-Simmons Tariff Act, ch. 16, 38 Stat. 114.

31 See Campbell and Raizenne, supra note 24.

32 Ibid.

33 United States, Revenue Act of 1932, 47 Stat. 169, section 143(b).

34 Campbell and Raizenne, supra note 24.

35 Pantaleo and Wilkie, supra note 10.

36 Campbell and Raizenne, supra note 24.

37 SC 1919, c. 55. In 1919 and the following early years of income taxation in Canada, the legitimization of a foreign tax claim as the basis for relief under the IWTA was married with the condition that, for countries other than Great Britain, reciprocity, in the nature of mutual accommodations of the kind framed by a tax treaty, was required. It is interesting, given that Canada was itself a dependency of Great Britain, that the sharing of tax jurisdiction that a foreign tax credit achieves was more or less absolute and unconditional in the Act. That said, the history of the foreign tax credit shows that parliamentarians grappled with the complexity of the calculation and discussed it with some particularity long after its original enactment, debating (among other things) elements of the credit concerned with the computation of relevant income, which raised timing and rate issues. See, for example, Canada, House of Commons, *Debates*, May 24, 1939, at 4476-81.

38 A Canadian-resident taxpayer can opt for deducting, as opposed to crediting, foreign taxes under subsection 20(11) or (12).

39 Section 110.5 permits a degree of elasticity not otherwise found in section 126 by permitting certain unutilized and effectively unutilizable foreign tax credits to be transformed into ordinary losses, the application of which is much less confined.

40 Subsection 3(4) of the 1917 IWTA was applied on the exercise of ministerial discretion and for the purposes of the supertax only.

41 The direct foreign tax credit is generous in its deference to foreign business-income tax, which effects exemption in fact if not in law. We recognize that ultimately income distributed by foreign affiliates may be taxed once it has been distributed out of corporate solution at any level, although as a practical matter it is likely that much foreign income is reinvested in the corporate group that earns it and therefore in practice remains untaxed indefinitely.

42 For further discussion, see Brian J. Arnold, *Reforming Canada's International Tax System: Toward Coherence and Simplicity* (Toronto: Canadian Tax Foundation, 2009), chapters 6 and 7; and Jinyan Li, Arthur Cockfield, and J. Scott Wilkie, *International Taxation in Canada: Principles and Practices*, 3d ed. (Markham, ON: LexisNexis Canada, 2014), chapters 13-15.

43 *Salomon v. Salomon & Co. Ltd.*, [1887] AC 22.

44 R. Easton Burns, *The Income War Tax Act 1917: A Digest* (Toronto: Canadian Chartered Accountants, 1917), at 5-6 and 22. (http://wartimecanada.ca/sites/default/files/documents/IncomeWarTax.1917.pdf).

45 Subsection 3(3) of the 1917 IWTA clarified that income from a business carried on in Canada was taxed on a net basis: "In the case of the income of persons residing or having their head office or principal place of business outside of Canada but carrying on business in Canada, either directly or through or in the name of any other person, the income shall be the net profit or gain arising from the business of such person in Canada."

46 Burns, supra note 44, at 22.

47 Income War Tax Act, SC 1924, c. 46 (herein referred to as "the 1924 IWTA"), paragraphs 3(2)(b) and 3(3)(b).

48 Parliamentary debates about this rule illustrate the concerns underlying each of the two connecting factors. One is to protect the tax base: the non-resident was profiting from Canadians while escaping tax by using certain formal arrangements. For example, speakers emphasized that the provision was intended to overcome the non-resident's escaping Canadian tax by virtue of the "technicality" of "the actual contract being completed abroad": Canada, House of Commons, *Debates*, May 27, 1924, at 2583-84; and June 10, 1924, at 3028. Another concern is administration. For example, one member commented that enforceability requires the presence of the non-resident or its agent in Canada: Canada, House of Commons, *Debates*, May 27, 1924, at 2584 (Drayton).

49 SC 1994, c. 7, schedule II, section 197(1). This was a response to the decision in *Minister of National Revenue v. Tara Exploration and Development Co. Ltd.*, [1974] SCR 1057, in which the court held that an adventure in the nature of trade was not carrying on business in Canada within the meaning of the 1972 Act. Non-residents would thus avoid Canadian tax on gains from the sale of Canadian real property if such property was not capital property, although the origin of the gain would clearly be Canada. The same rationale applies to Canadian resource property and timber resource property.

50 In this regard, it is interesting to note a similarly directed amendment to the Income Tax Conventions Interpretation Act in 1998 to reinforce the Canadian origin of gains from dispositions of taxable Canadian property. (Income Tax Conventions Interpretation Act, RSC 1985, c. I-4, as amended by SC 1999, c. 22, by adding section 6.3. This change and the addition of paragraph 253(c) to the Income Tax Act addressed the use of legal—indeed, legalistic—devices essentially to re-source income on the basis of considerations of legal situs, which had little to do, presumably it was thought, with how to determine where income originates.

51 Income Tax Act, SC 1948, c. 52 (herein referred to as "the 1948 Act"), subsection 96(1).

52 This is an important observation that properly situates the withholding element of withholding tax as principally, or mostly, a procedural expedient to deal with the legal reality that revenue laws may not generally be enforced extraterritorially and, in any event, would be difficult to enforce against persons without any source-country presence. The United States imposed withholding tax on "fixed, determinable, annual, periodical" payments. The influence of the US approach was evident in the enactment of paragraph 9B(2)(f) of the Income War Tax Act, SC 1932-33, c. 41 (herein referred to as "the 1932-33 IWTA"). Entitled "Salaries and other periodical payments," this provision imposed a 15 percent income tax by withholding on "salaries, wages, premiums, annuities, compensation, remunerations, emoluments, rents and other fixed or determinable annual or periodical gains, profits and income received from sources within Canada by any such non-resident person who is not engaged in trade or business within Canada, has not an office or place of business therein, and has not performed personal services within Canada, at any time in the year, provided that such non-resident is a resident of a country which imposes a tax of a similar nature in respect of similar kinds of income derived from sources within such country and payable to non-residents of such country." Aside from what appears to be US nomenclature, at least in contemporary terms, the wording of the provision is notable for its emphasis on where activities generating income do or do not take place and for the contextual association of the enumerated payments with activities that are by their nature indicative of some sort of business, using descriptors consistent with how the qualitative items of Canadian residents' income would be determined.

53 See regulation 805. The inherent nature of a royalty as business income and jurisdictional connections akin to a permanent establishment created by a non-resident's property in a source country are considered by J. Scott Wilkie in a paper prepared for the United Nations Committee of Experts on International Cooperation in Tax Matters, "The Character and Purpose of Article 12 with Reference to 'Industrial, Commercial and Scientific Equipment' and Software-Payment Related Issues," UN document no. E/C.18/2015/CRP.6, October 13, 2015.

54 Supra note 53, and Wilkie, supra note 15.

55 This is indicated in parliamentary debates. For instance, one member remarked, "There are two underlying principles. The one is residence . . . The other is the carrying on of business

[in Canada] . . . Supposing the Canadian national living in England, has mortgages, has lent money here. They are not taxable. That is not carrying on a business. On the other hand, if that non-resident owned realty in Canada and through his agents here . . . received rents, he would be taxable for those rents under the existing law." Canada, House of Commons, *Debates*, June 10, 1924, at 3029 (Drayton).

56 Supra note 52. Subsection 9B(2) became subsection 96(1) of the 1948 Act, subsection 106(1) of the 1952 Act, and subsection 212(2) and paragraph 212(1)(b) of the current Act.

57 Herbert A.W. Plaxton, *The Law Relating to Income Tax of the Dominion of Canada* (Toronto: Carswell, 1939), at 158.

58 Corporate residence is not the only basis for determining the Canadian source of interest. By virtue of subsections 212(13) and (13.1), interest paid and deducted by a non-resident person in computing its COBIC income for part I tax purposes is deemed to have been paid by a resident person for part XIII purposes. In effect, by the same logic, tax-deductible interest and other charges are considered to have a Canadian source.

59 Supra note 27.

60 SC 1980-81-82-83, c. 48, section 108(10); and SC 1985, c. 45, section 122(3).

61 Supra note 50.

62 The effect of the amendment was to reduce the scope of the "taxable Canadian property" definition to approximate the scope of Canada's taxing right under its bilateral tax treaties.

63 For discussion of the foreign tax credit generator rules, see below under the heading "Legislative Expressions of Source."

64 This is something of an overstatement since, for example, one role of tax treaties is to "attribute" business income to business presences, and classification or qualification conflicts sometimes make it difficult to determine whether foreign tax recognition is as smooth and seamless as it is meant to be.

65 Canadian case law sheds some light on the territorial origin of income, especially in respect of the foreign tax credit and COBIC income. See Li, supra note 10.

66 For further discussion, see J. Scott Wilkie and Peter W. Hogg, "Tax Law Within the Larger Legal System" (2005) 52:2 *Osgoode Hall Law Journal* 463-90; and Matias Milet and Christopher Sheridan, "The Income Tax Act as 'Accessory': A Modern Re-Examination," 13:1-31, elsewhere in this volume.

67 The Act contains particular limitations that may stream income and losses from both qualitative and territorial sources; so, for these sorts of purposes, it may be important to devise a refined awareness of how income or loss arose in the first place. But the basic source questions typically have been left to be determined by the private law and, to the extent that international considerations arose, to be resolved through the application of conflict-of-law principles (see below) and tax treaties.

68 While disagreements about the qualitative source of income are possible and have occurred, in the main—at least historically—the qualitative elements of the Canadian tax base for residents and non-residents have been fairly clear and, except when distinguishing trading from capital gains, generally uncontested. There are, of course, exceptions, including the tracking of losses for application after a change of control.

69 See section 115.

70 For the same reason, there was not much need for prescriptive source rules since little turns on them for residents and non-residents.

71 For example, *Income Tax Folio* S5-F2-C1, "Foreign Tax Credit" (discussing the determination of foreign-source business income and non-business income).

72 See the discussion in the next section.

73 As early as 1932-33, provisions concerning personal corporations were amended in a way resembling the FAPI regime. They looked through a non-resident corporation and attributed its income to its Canadian shareholder for tax purposes: see Canada, House of Commons, *Debates*, January 31, 1933, at 1672 (Rhodes).

74 "Foreign accrual property income" is defined in subsection 95(1) to include income from property, certain taxable capital gains, and income from a business other than an active business. A definition of "income from property" was added in 1995 (SC 1995, c. 21, section 46(3)) to specifically include income from two types of businesses that derive value predominantly from property—that is, an "investment business" and income from an adventure in the nature of trade.

75 E.J. Benson, *Proposals for Tax Reform* (Ottawa: Department of Finance, 1969), at 74: "Some [foreign corporations] are merely devices of convenience to which income from other sources—dividends, interest, royalties and trans-shipment profits—may easily be diverted. The dividend exemption system would permit such income to be brought back to Canada tax-free. Even the tax-credit system would permit the Canadian tax on such income to be postponed indefinitely."

76 See subsection 95(5) added by SC 1949 (2d sess.), c. 25, section 38(6); subsection 95(6) added by SC 1950, c. 40, section 33(2); and subsections 96(7) and (8) added by SC 1952-53, c. 40, section 36(2). Subsections 96(5) through (8) became subsections 106(5) through (8) of the 1952 Act.

77 See Burns, supra note 44, at 22.

78 Herbert A.W. Plaxton, *The Law Relating to Income Tax and Excess Profits Tax of the Dominion of Canada*, 2d ed. (Toronto: Carswell, 1947), at 278. A subsequent amendment added "parent, subsidiary or associated corporation or partnership"; see the 1924 IWTA, section 2.

79 The intercompany purchases and sales provision under subsection 3(2) of the 1917 IWTA was amended and became section 23 per the 1924 IWTA, section 2.

80 SC 1998, c. 19.

81 Canada, House of Commons, *Debates*, June 10, 1924, at 3027.

82 Supra note 27.

83 Supra note 75, at 77.

84 SC 1934, c. 55, section 12.

85 Under section 18 of the IWTA, SC 1940-41, c. 18, section 20, any loan or advance by a Canadian corporation to a shareholder was deemed to be a dividend to the extent that the corporation had undistributed income on hand, and the deemed dividend would be deemed to be income received by the shareholder in the year in which the loan or advance was made. It was possible that the minister could assess the Canadian corporation on the imputed interest income while the shareholder would be deemed to have received a dividend under section 18; see *Kayser & Co. Ltd. v. Minister of National Revenue*, [1940] Ex. CR 66. In *Kayser*, a wholly owned subsidiary in Canada made advances of substantial amounts out of its undistributed income to its non-resident parent company, and no interest was paid or credited to the subsidiary company by the parent company on the advances. It was held that section 18 was only applicable in determining the income of the shareholder, while section 23A applied to such advances and 3 percent interest was added to the subsidiary's income.

86 The new capital gains tax regime attempted to accommodate the former rules through various surplus accounts to preserve the non-taxability of certain pre-existing income or gains. The complications resulting from this arrangement were eventually relieved in 1977, when those transitional accounts ceased to have general effect. For further discussion, see Wilkie, supra note 28.

87 Canada, Department of Finance, *Explanatory Notes Relating to the Income Tax Act and Regulations* (Ottawa: Department of Finance, August 2012), at 86.

88 See subsections 212(3.1) through (3.4) and following, and from the 2016 federal budget, proposed subsections 15(2.16) through (2.19), 15(2.191) through (2.192), 80.4(2) and (7), and 212(3.1) through (3.94). Canada, Department of Finance, 2016 Budget, March 22, 2016.

89 See supra note 10.

90 See Wilkie, supra note 53.

91 See Wilkie, supra note 28, and Couzin, supra note 10.

92 See Wilkie, supra note 15.

93 It may in fact be that, directionally, taxing states are wittingly or otherwise engaged in a process of devising negative source rules closely connected to the fiscal integrity, or not, of organizational forms and contracts. In other words, recognizing the unlikelihood and the legal difficulty of agreeing to universal affirmative source rules, states are instead establishing where the source of income cannot be, with reference to the functional and financial capacity of putative income earners actually to be able to earn income otherwise attributed to them. This way of thinking about source directly implicates the significance and utility of legal personalities as focal points for income in any system, as well as a possibly more important evolving need for mechanisms that disclose relevant factors affecting how income is earned simultaneously to all potentially interested states, so that their claims to tax can be staked and intersections resolved through enhanced dispute relief means, if not by formula.

94 Supra note 8.