No. 2026-200
August 28, 2026

U.S. Court of Federal Claims: Canadian charity not entitled under Canada treaty to refund of pro rata share of tax withheld on dividend income earned through Canadian unit trust

The U.S. Court of Federal Claims on August 25, 2026, held that the taxpayer, a Canadian charity, was not entitled under the U.S.-Canada income tax treaty to a refund of its pro rata share of income tax withheld on U.S.-source dividend income it earned through a Canadian "unit trust."

The court found that even though the taxpayer was a tax-exempt charitable entity and "derived" the income through a "fiscally transparent entity," Article XXI(3) of the treaty allowed tax-exempt charitable entities to obtain reciprocal tax treatment only by investing through pooled investments specified in that provision, which did not include unit trusts.

The case is: *The South Saskatchewan Community Foundation Inc. v. United States*, No. 24-1391T (Fed. Cl. Aug. 25, 2026). Read the Court of Federal Claims' **opinion**.

Summary

As a charity, the taxpayer does not pay taxes in Canada on the earnings from its invested assets. During the 2019 and 2020 tax years, the taxpayer invested a portion of its endowment in a Canadian unit trust. Among its holdings, the unit trust owned U.S. equities, and in tax years 2019 and 2020, the unit trust's qualified intermediary withheld and remitted to the IRS tax on all the unit trust's U.S.-source dividend income.

The taxpayer sought a refund of its pro rata share of the income tax withheld by the qualified intermediary under Article XXI(1) of the U.S.-Canada income tax treaty, which generally exempts qualifying charitable organizations like the taxpayer from tax in the other treaty country to the extent the income is exempt in their home country. The taxpayer contended that under Article IV(6) of the treaty, which provides that provides that income may be "derived" by a resident of a contracting state if the entity through which the resident derives the income is fiscally transparent, it derived the income through a "fiscally transparent entity" and was thus entitled to the tax exemption under the treaty.

The IRS rejected the taxpayer's refund claim, arguing that the United States and Canada did not intend for Article IV(6) to apply to charities at all, and if it did apply, the provision did not cover unit trusts or the income they derive, even when the beneficiary is a charity. The IRS argued that Article XXI(3) of the treaty, which specifically addresses tax-exempt organizations investing through pooled investment vehicles, was the only avenue for the taxpayer to preserve its tax-exempt status. The IRS relied on the Technical Explanation to the Fifth Protocol to the treaty, as well as the treaty's text and amendment history, to contend that whether unit trusts are fiscally transparent or not, the shared understanding of both the United States and Canada was that charities with holdings in unit trusts are unable to take advantage of Article IV(6)(b) in lieu of the express provision of Article XXI(3).

The Federal Claims Court found that if the taxpayer were correct in its interpretation of the treaty, it would prevail as it meets the definition of fiscally transparent under Treas. Reg. § 1.894-1(d)(3)(iii). The court stated that the taxpayer "need not establish that every Canadian unit trust is fiscally transparent as to every item of income. It need only establish that, under Canadian law, it was required to take its allocable share of the [the unit trust]'s U.S.-source dividends into account on a current basis, whether those dividends were 'distributed' or not." Under Canadian law, a unit trust beneficiary is required to include in its income the portion of the trust's income for the year that becomes "payable" to the beneficiary in that year, which includes income with respect to which the beneficiary is entitled to enforce payment that year. Because the U.S.-source dividend income became payable to the unit trust holders each tax year (i.e., the unit trust holders were entitled to enforce payment), the taxpayer was required to include its share of the dividend income in its income for that year, whether or not the funds were distributed.

The IRS argued that under Treas. Reg. § 1.301-1(c), which provides that a corporate distribution is included in a shareholder's gross income when cash or other property is "unqualifiedly made subject to [the shareholder's] demands," the taxpayer's enforceable right to payment of the unit trust's U.S.-source dividend income was itself a "distribution." Thus, the taxpayer did not show that Canadian law requires it to account for the U.S.-source dividends whether or not they were distributed. The court found, however, that under the best reading (i.e., the ordinary meaning) of Treas. Reg. § 1.301-1(c), the relevant inquiry is not whether the taxpayer had an enforceable right to demand payment, but whether Canadian law required the taxpayer to include its allocable share of the U.S.-source dividends in its income, even if the funds remain held by the unit trust. Under that reading, the taxpayer satisfied the income-inclusion rule for fiscal transparency.

However, the court found that the treaty's text, structure, and amendment history, confirmed by the Technical Explanation of the Fifth Protocol to the treaty, reflect that the signatories did not intend Article IV(6) to provide charities an alternative avenue to avoid taxation on income that does not qualify under Article XXI(3). Instead, through the adoption of Article XXI(3), the signatories intended that tax-exempt charitable entities could obtain reciprocal tax treatment only by investing through pooled investments specified in that provision. In addition, the Technical Explanation reflects that unit trusts do not satisfy Article IV(6). Accordingly, the court held in favor of the IRS.

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