BETWEEN:

UNITED GEOPHYSICAL COMPANY OF CANADA ..... APPELLANT;

1960
May 9

1961
Mar. 23

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Revenue—Income tax—Non-resident company—Subsidiary rented equipment in United States from parent company for use in Canada—Whether parent company carrying on business in Canada—Whether subsidiary its agent—Whether equipment payments "rent for use in Canada of property"—The Income Tax Act, R.S.C. 1952, c. 148, ss. 2(2), 31(1), 106(1)(d), 108(9), 109(1), 123(8)(10), 139(7), Income Tax Regulation 805(1).

The appellant company was incorporated in California in 1955 as a wholly-owned subsidiary of the United Geophysical Corporation, another California corporation which supplies geophysical services to oil companies. In May 1955 the appellant assumed the Canadian portion of the Corporation's assets in Canada and assuming its liabilities there. Equipment items of United States origin were not sold but by the terms of a written agreement the Corporation agreed to "rent" to the appellant necessary equipment for use in its Canadian operations. The rental was to be determined in California and to start on equipment leaving any place in the United States. Pursuant to the agreement the appellant in 1955 and 1956 paid the Corporation the sums agreed on as rental for the equipment supplied it by the Corporation. The Minister pursuant to s. 123(10) of the *Income Tax Act* assessed the appellant for the amount of tax he contended it should have under s. 123(8) withheld and paid to the Crown out of the sums it paid its parent company, a non-resident corporation. In an appeal from the assessment the appellant contended that the Corporation carried on business in Canada in 1955 and 1956 and was therefore subject to tax under Part I rather than Part III of the *Income Tax Act*. It submitted that the business carried on in Canada was the Corporation's business and that the appellant acted only as its agent, or in the alternative, that the Corporation itself carried on business in Canada by putting its equipment to use there and deriving income therefrom.

Held: That during the material period the business carried on by the appellant was its own and not that of the Corporation.

2. That the "rental" for the equipment was income from that part of the Corporation's business carried on in the United States and could not be reasonably attributed to any part of the business which may have been carried on in Canada and therefore was not taxable under Part I but under Part III of the *Income Tax Act*.

3. That s. 106(1)(*d*) of the *Income Tax Act* refers to and includes a fixed amount paid as rental for the use of personal property for a certain time and the sums in question were amounts of the kind referred to in the section.

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

APPEAL under the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Thurlow at Ottawa.

K. E. Eaton and *R. H. McKercher* for appellant.

G. W. Ainslie and *J. M. Bentley* for respondent.

THURLOW J. now (March 23, 1961) delivered the following judgment:

These are appeals from assessments made pursuant to s. 123(10) of the *Income Tax Act,* R.S.C. 1952, c. 148, against the appellant in respect of the 1955 and 1956 taxation years. By that subsection the Minister is empowered to assess any person for any amount that is payable under that section, and by s-s. (8) of the same section it is enacted that any person who has failed to deduct or withhold any amount as required by the Act or a regulation from a non-resident is liable to pay to Her Majesty the whole amount that should have been deducted or withheld with interest. The assessments under appeal were raised under these provisions in respect of tax which the Minister contends should have been deducted or withheld and paid to the Crown by the appellant on sums of $194,075 and $298,830 paid by the appellant in 1955 and 1956 respectively to its parent company, United Geophysical Corporation, a non-resident corporation.

In order to point out the issues, it will be convenient to refer to some of the relevant provisions of the statute. By s. 106(1), an income tax of 15% is imposed on every non-resident person in respect of every amount that a person resident in Canada pays or credits to him for, *inter alia,* "rent, royalty or a similar payment, including, but not so as to restrict the generality of the foregoing any such a payment for the use in Canada of property." By s. 109(1), when a person pays or credits to a non-resident person an amount of this nature he is required to deduct or withhold therefrom the amount of the tax and remit it to the Receiver-General of Canada on behalf of the non-resident person on account of the tax. One of the issues in the appeals is whether the sums in question were payments of the nature referred to in s. 106(1).

Sections 106 to 110 inclusive form Part III of the Act and, in general, deal with tax on non-residents in respect of their Canadian income of particular specified kinds, including dividends, interest, income from estates or trusts, rents, royalties, etc. In Part I, however, by s. 2(2) income tax is imposed as well on any non-resident person who was employed in Canada or carried on business in Canada at any time in the year in respect of his taxable income earned in Canada.

By s. 108(9) the Governor-in-Council is authorized to make regulations for the purposes of Part III prescribing, *inter alia*:

> (*c*) where a non-resident person carries on business in Canada, what amounts are taxable under this Part [Part III] or what portion of the tax under this Part is payable by that person.

Prior to 1955, the following regulation had been made, and it remained in force and unaltered throughout 1955 and 1956.

> 805. (1) Where a non-resident person, other than a registered non-resident insurance company, carries on business in Canada he shall be taxable under Part III of the Act and all amounts otherwise taxable under that Part except such amounts as are included in computing his income for the purpose of Part I of the Act.

It will be observed that both s. 108(9) and Regulation 805(1) are limited in their application to cases where the non-resident person carries on business in Canada but that, when that situation obtains, by virtue of the regulation, the taxpayer is not taxable under Part III in respect of amounts which are to be included in computing his income for the purposes of Part I. A second issue in the appeals is whether the appellant's parent, United Geophysical Corporation, carried on business in Canada at the material times. If so, a third issue is whether the amounts in question fall within the meaning of the expression "such amounts as are included in computing his income for the purpose of Part I of the Act." This in turn depends on whether the amounts were "income earned in Canada," for it is only in respect of such income that tax under Part I is imposed on a non-resident, and such income alone is included in computing a non-resident's income for the purposes of Part I.

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

Thurlow J.

Two additional provisions of the statute bearing on the last-mentioned issues are s. 31(1) and 139(7), which were as follows:

31. (1) For the purposes of this Act, a non-resident person's taxable income earned in Canada for a taxation year is

(*a*) the part of his income for the year that may reasonably be attributed to the duties performed by him in Canada or the business carried on by him in Canada,

minus

(*b*) the aggregate of such of the deductions from income permitted for determining taxable income as may reasonably be considered wholly applicable and of such part of any other of the said deductions as may reasonably be considered applicable.

* * *

139. (7) Where, in a taxation year, a non-resident person

(*a*) produced, grew, mined, created, manufactured, fabricated, improved, packed, preserved or constructed, in whole or in part, anything in Canada whether or not he exported that thing without selling it prior to exportation, or

(*b*) solicited orders or offered anything for sale in Canada through an agent or servant whether the contract or transaction was to be completed inside or outside Canada or partly outside Canada.

he shall be deemed, for the purposes of this Act, to have been carrying on business in Canada in the year.

The appellant is a California corporation incorporated in April, 1955 and is a wholly-owned subsidiary of United Geophysical Corporation, another California corporation which is engaged as a contractor supplying geophysical services to oil companies in the United States and which has subsidiary or affiliated companies engaged in offering similar services in various other countries. United Geophysical Corporation (which will be referred to as the "Corporation") was incorporated in August, 1954 and on September 1 of that year acquired the undertaking of two earlier related corporations, one of which had been engaged in the same business in the United States and the other in Canada. Thereafter, the Corporation itself carried on business in the United States and in Canada until May 1, 1955, when the appellant assumed the Canadian portion of the operation. At that time, by an agreement not committed to writing, the Corporation's assets in Canada which had been acquired from Canadian suppliers, plus the Canadian accounts receivable and other cash assets of the Canadian operation, were sold by the Corporation to the appellant. The equipment items of United States origin were not sold to the

appellant but "rented" to it upon the terms of a written agreement by which the Corporation agreed to "rent" to the appellant necessary equipment for use in its Canadian operations, the rental to be determined in Pasadena, California, giving due consideration to reasonableness and total cost of each item of equipment. The agreement contained no undertaking on the part of the Corporation to service or repair the equipment, but it did provide that "rental" should start on the equipment leaving Pasadena or any other place in the United States. At the same time, the appellant assumed the Corporation's liabilities arising from the Canadian operations, and the employees of the Corporation who were resident in Canada became employees of the appellant. The Corporation continued its registration under Part VIII of the *Companies Act* of the Province of Alberta, but after May 1, 1955, it had no office or workshop or bank accounts or other assets (except the equipment "rented" to the appellant) in Canada. Its head office, as well as that of the appellant, was in California, where most of the directors of both companies lived and where all meetings of the shareholders and directors of both companies were held. Within the board of directors of the Corporation, an executive committee consisting of all of its members had been constituted to which various members of the committee reported from time to time in respect of particular phases of the Corporation's operations for which they were responsible. No such committee was organized by the board of directors of the appellant. As occasion required, consultations took place between the manager of the appellant's Canadian operations, who was a director or officer of both companies and lived in Calgary, and various members of the boards of directors, depending on the nature of the matter and the director responsible for it, and reports on operations in Canada were systematically rendered to the same members. In each case, however, the member concerned was an officer or director of the appellant and, though he was employed and paid by the Corporation, the appellant was charged each month a portion of the Corporation's administrative expenses, which included the salaries of such officers.

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

Thurlow J.

On several occasions during the period in question, work of a kind which the appellant was not equipped to handle, involving the evaluation of information and the preparation of reports and charts therefrom, was solicited by the appellant's manager in Canada and, on being ordered, was referred to Pasadena, where the work was done, the result being forwarded to the client either directly or through the appellant. An invoice for such work would then be submitted by the Corporation to the appellant, who would pay it and collect the amount from the Canadian client. The appellant's manager, who was paid by the appellant, also at times solicited clients in Canada for orders for work to be done by the Corporation in the United States.

Over the period from May 1, 1955 to December 31, 1956, several persons who were in the employ of the Corporation and who, with one exception, were also directors or officers of both the appellant and the Corporation came to Canada on several occasions for various purposes connected with the Canadian operations. Among others, those purposes included observing the operation of the equipment, with a view to designing improvements, making improvements to such equipment, assisting in servicing and repairing the equipment, and contacting persons requiring services of the kind offered, with a view to satisfying their requirements and promoting the business. The travelling expenses in connection with these visits were paid by the Corporation and subsequently charged to and paid by the appellant. The salaries of these persons were also paid by the Corporation, and with the possible exception of the employee who was not a director, were included in the Corporation's administration expenses, a portion of which was charged each month to the appellant.

The sums of $194,075 and $298,830 in question were paid by the appellant to the Corporation in 1955 and 1956 respectively, pursuant to the agreement, as "rental" for equipment the ownership of which was retained by the Corporation and for additional equipment "rented" to the appellant in those years. In each case, the "rental" was approximately the amount of the depreciation of the equipment estimated on a straight line basis, so as to write off the cost of the equipment over its expected life. No "rental" was charged or paid on equipment the cost of which had been

completely written off or recovered as "rental", even though some such equipment may have remained in use by the appellant.

The appellant's contention that the Corporation carried on business in Canada during 1955 and 1956 and was, therefore, subject to taxation on the sums in question under Part I of the *Income Tax Act,* rather than under Part III, was put in two ways. It was submitted first that the whole business activity carried out in Canada was the Corporation's business and that the appellant was but the Corporation's agent in all that it did. Alternatively, it was submitted that the Corporation itself carried on business in Canada by putting its equipment into use in Canada, keeping it in use through repairing and servicing it in Canada, and deriving income from its use there. It was said that the Corporation's business was a composite one comprising all its activities which were carried out for the purpose of putting and keeping its equipment in operation in Canada and elsewhere to its profit, that it is artficial to attempt to split up the business and not realistic to describe any of its results as income from property, that the supplying of the equipment in the United States was but the beginning of what the Corporation did to gain the income in question, since only its personnel knew how to service and repair the equipment and thus keep it in use, which servicing and repairing was done by the Corporation in Canada, and that these activities fall within the statutory definition of carrying on business in s. 139(7) of the Act, even if they might not otherwise be sufficient to amount to carrying on business.

In my opinion, the contention that the appellant was merely an agent for the Corporation and that the business carried on in Canada by the appellant was in reality the Corporation's business is not borne out by the evidence. While it is clear that a business can be carried on by a company as agent for a disclosed or an undisclosed principal, unless the company which carried on the business is nothing but a sham the mere fact of ownership by a person of all the shares of that company will not make the company's business that of the owner of the shares, nor will complete and detailed domination by that owner of every move the company makes be sufficient to make the company his agent or

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

Thurlow J.

the business his own, for the company, if legally incorporated, has a legal existence and personality of its own, distinct from that of the owner or owners of its shares. The same applies where the owner of the shares is itself an incorporated company. Here the Corporation prior to May 1, 1955, was engaged in carrying on business both in Canada and elsewhere, and its purpose in having the appellant incorporated was to have it take over the Canadian operations then carried on by the Corporation itself. This was done because it was considered desirable for the purpose of obtaining a tax advantage in the United States. Mr. Malmgren, the assistant secretary of both companies, explained this as follows:

> The incorporation of the appellant was primarily to obtain a United States tax advantage as regards the earnings of the companies in the United States. In other words, each corporation—that is, United States corporation—is subject to a tax on a graduated basis, the first $25,000 of earned income being subject to a 30 per cent tax, all earnings over that being subject to a 52 per cent tax. With the operations, both in the United States and in Canada, being conducted by one corporation, there was only one $25,000 lower-bracket tax benefit there. With two corporations, we would then have the United States tax benefit on the first $25,000 wholly within the United States and receive this 30 per cent tax benefit, and therefore we formed this corporation to receive this additional $25,000 lower tax bracket benefit in Canada, so that the Canadian earnings would not dissipate the earned income in the United States which would be subject to this 30 per cent tax rate.

To my mind, this does not indicate an intention that the Corporation should continue the operations in Canada on its own account, nor was it suggested by any witness that it was considered sufficient in order to gain the desired advantage to have the Corporation keep that business as its own and have it carried on through an agent in Canada. To carry out its purpose, the Corporation in April, 1955, sold certain of its assets in Canada to the appellant and arranged to provide it with equipment at a "rental", and the appellant assumed the Corporation's liabilities which had arisen in connection with its Canadian operations. These facts, while not necessarily inconsistent with an intention that the appellant should be a mere agent or that the business to be carried on by it should continue to belong to the Corporation, strike me as indicating that the intention was that the business thereafter would be that of the appellant itself and in this context may be considered the fact that no resolution was ever passed by the Corporation

to appoint the appellant its agent or by the appellant to accept appointment as such an agent, nor was any agency agreement made between them. Next, it appears that at the end of its first and second fiscal periods the appellant's accounts were made up so as to show the profits of its operations as its own and nowhere to indicate or even suggest that the appellant was under liability to account to the Corporation for these profits as its agent, and this even though the appellant's liability to the Corporation for money loaned or credit extended is clearly shown. Moreover, the appellant, which was throughout completely dominated by the Corporation, in both years reported and paid income tax on such profits as income of the appellant and in its first income tax return stated that it had been "formed as a wholly owned subsidiary of United Geophysical Corporation and assumed its Canadian operations on May 1st, 1955."

Taken together, these facts, in my opinion, point strongly to the conclusion that the business carried on by the appellant was its own and nothing in the rest of the evidence points even weakly to the other conclusion. Accordingly, I am of the opinion that, during the material period, the business carried on by the appellant was its own and not that of the Corporation.

I turn now to the appellant's alternative submission, that the Corporation itself carried on business in Canada during the material times. This appears to me to depend to a great extent on just what the Corporation's business consisted of, since on the facts there obviously were activities of one sort or another carried on by or on behalf of the Corporation in Canada during the material period. There are, to my mind, at least two possible views of the scope of the Corporation's business. In the narrower of them, the Corporation from its inception had but one business, which embraced the supplying of geophysical services to clients and which was carried on by the Corporation in both the United States and Canada until May 1, 1955, when the Corporation discontinued carrying on in Canada the portion thereof which the appellant then assumed. In this view, the Corporation at that time discontinued using in its business the equipment which it then rented to the appellant, and the income therefrom received thereafter in the form of rentals was not income

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

Thurlow J.

from the appellant's business but was income from property. It would thus become immaterial for the present purpose whether any part of the business was carried on in Canada during the period in question for, in any case, the "rentals" in question would not be income of that business and, having regard to ss. 2(2) and 31(1), would not be taxable under Part I of the Act and would not be included in computing the Corporation's income for the purposes of that Part.

The other and wider view of the scope of the Corporation's business is that it embraced the supplying of geophysical services to clients but included as a sideline after May 1, 1955, the providing at approximately cost to the appellant, its wholly-owned subsidiary, of administrative, supervisory and other services, as well as equipment for the appellant's use. This, I think, is the correct view, and in it, having regard to the English cases cited in the course of argument, including *Smidth v. Greenwood*[1], *Weiss, Biheller and Brooks v. Farmer*[2], *and Firestone Tyre Co. Ltd. v. Lewellin*[3], and to s. 139(7) of the Act, I find it impossible to say that the Corporation carried on none of its business in Canada during the material period for the services provided by the Corporation to the appellant, *ex hypothesi,* were such as it was part of the Corporation's business to provide and they were rendered in Canada, and the soliciting by the appellant's manager in Canada of orders for work to be carried out by the Corporation in the United States appears to me to fall within the definition, as well. Accordingly, I shall assume for this purpose that the Corporation to some extent did carry on business in Canada, from which assumption it would follow by virtue of s. 108(9) and Regulation 805(1) that the Corporation was not taxable under Part III in respect of any of its income which was taxable under Part I, and the further question would arise whether the sums in question were amounts which would be included in computing the corporation's income for the purposes of Part I.

Under s. 31(1) as it was in 1955 and 1956, a non-resident person's taxable income earned in Canada (which is what is taxable under Part I pursuant to s. 2(2)) is defined as the

[1] 8 T.C. 193.

[2] [1923] 1 K.B. 226; 8 T.C. 381.

[3] [1957] 1 All E.R. 561.

"part of his income for the year that may reasonably be attributed to . . . the business carried on by him in Canada." In this subsection, the word "business" appears to me to refer to the income- or profit-earning activities carried on by the non-resident person in Canada, and the question to be answered thus depends on whether or not the sums in question may reasonably be attributed to the business carried on by the appellant in Canada.

Now, the facts with respect to the "rental" are, first, that the governing agreement was made in the United States. By itself, this fact does not carry the matter far (*vide* the comments of Lord Radcliffe in *Firestone Tyre Co. Ltd. v. Lewellin, supra*), but it can be of no help to the appellant on whom the onus of proof lay. Next, the agreement provides that the rental is to be determined in the United States, where on the evidence it was in each case in fact determined. It is also provided that the rental shall start when the equipment leaves Pasadena or some other place in the United States. Though the agreement is silent on the question as to where delivery of the equipment is to be made, it would seem to flow from these provisions that the intention was that the equipment would be supplied in the United States and that the appellant would take possession of it there, but in any case, save for the equipment which was already in Canada on May 1, 1955, I see no reason on the evidence to think that delivery to the appellant of any of the equipment took place anywhere but in the United States. Nor is it established that payment of the rental was received anywhere but in the United States. Nor do I think it can be said that the "rental" resulted in any proximate sense from the servicing or repairing of the equipment in Canada. In my view, the rental came to the Corporation not from the actual use made of the equipment by the appellant, which had no effect on the amount or any other feature of it, but from the hiring of the equipment by the Corporation to the appellant upon the terms of the written agreement, a matter which on each occasion was, I think, arranged in the United States. Accordingly, in this view, as well, of the scope of the Corporation's business, I am of the opinion that the "rental" for the equipment was income from that part of its business which was carried on in the United States and could not reasonably be attributed to any

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

Thurlow J.

part of the business which may have been carried on by the Corporation in Canada. Such rental would not, therefore, be taxable under Part I of the Act or be included in computing the Corporation's income for the purposes of that Part.

The appellant's submission that the Corporation was taxable in respect of the "rentals" under Part I of the *Income Tax Act*, rather than under Part III, accordingly fails.

There remains the question whether the sums in question are income of the kind in respect of which tax is imposed by s. 106(1). By clause (d) of this subsection, tax is imposed in respect of

> rent, royalty or a similar payment, including, but not so as to restrict the generality of the foregoing, any such a payment
>
> (i) for the use in Canada of property,
>
> (ii) in respect of an invention used in Canada, or
>
> (iii) for any property, trade name, design or other thing whatsoever used or sold in Canada,
>
> but not including
>
> (A) a royalty or similar payment on or in respect of a copyright, or
>
> (B) a payment in respect of the use by a railway company of railway rolling stock as defined by paragraph (25) of section 2 of the *Railway Act*;

The assessments are founded on the assumption that the sums in question were "rent . . . or a similar payment including but not so as to restrict the generality of the foregoing, any such a payment for the use in Canada of property" within the meaning of this subsection.

On behalf of the appellant, it was submitted that the word "rent" is a technical term used to refer to a profit issuing from real property, that the words "or any similar payment including any such a payment for the use of property" which follow "rent" in s. 106 are to be construed as meaning payments having the characteristics of rent and that the payments in question do not have such characteristics, there being no certainty in the agreement as to the amount to be paid or as to the time when payment is to be made.

It is, I think, apparent from the use in the section of the wording which follows the words "rent" and "royalty" that Parliament did not intend to limit the type of income referred to in the subsection to either what could strictly be called "rent" or "royalty" or to payments which had all

of the strict legal characteristics of "rent" or "royalty". Nor does the scope of the section appear to be restricted to payments of that nature in respect of real property for the word "property" appears in the section and that word is defined in very broad terms in s. 139(1)(*ag*) as including both real and personal property. It seems to me, therefore, that s. 106(1)(*d*) includes any payment which is similar to rent but which is payable in respect of personal property. Moreover, in its ordinary usage, as opposed to its technical legal meaning, the word "rent", besides referring to returns of that nature from real property, is broad enough to include a payment for the hire of personal property. Thus the *Shorter Oxford Dictionary* gives as one of the meanings of the word, "The sum paid for the use of machinery, etc. for a certain time." In this definition, there are but two characteristics of the sum, namely it is for the use of machinery, etc. and it is paid for that use for a certain time. See also the usage of the word in *Brooks v. Beirnstein*[1] and *National Cash Register Co. Ltd. v. Stanley*[2]. Without attempting to determine just how wide the net of s. 106(1)(*d*) may be, I am of the opinion that the subsection does refer to and include a fixed amount paid as rental for the use of personal property for a certain time.

Now it goes without saying that the mere use of the words "rent" and "rental" in the agreement between the Corporation and the appellant is not necessarily conclusive on the question whether the payment so provided for is in fact a rent or other payment of the kind referred to in s. 106(1), but their use in the agreement, to my mind, affords some indication that the payment which was to be determined, having regard to reasonableness and the cost of each item to be "rented", was to be a payment in the nature of rent for the equipment. The fact that the amount of the rent was not set in the written agreement is, to my mind, entirely immaterial, for the document was only an agreement on some points, and it was open to the parties to set, as in practice I think they did, the rent for each item when it was hired by the appellant pursuant to that agreement. Moreover, the fact that it was agreed that the "rental" was to commence in each case at a time settled by the agreement

[1] [1909] 1 K.B. 98.

[2] [1921] 3 K.B. 292.

1961

UNITED GEOPHYSICAL CO. OF CANADA v. MINISTER OF NATIONAL REVENUE

Thurlow J.

and the fact that the amount was, as stated by Mr. Malmgren, "at a monthly rate per item," in my view show that it was an amount in respect of a certain time. I am, accordingly, of the opinion that the sums in question were amounts of the kind referred to in s. 106(1).

The appeals, therefore, fail, and they will be dismissed with costs.

Judgment accordingly.